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No. 91-42-CFX
Status: GRANTED

Title: United States, Petitioner
v.
Therese A. Burke, Cynthia R. Center, and Linda G. Gibbs

Docketed:
July 3, 1991

Court: United States Court of Appeals for the Sixth Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Finley,Joseph E.

Entry	Date	Note	Proceedings and Orders
1	Jul 3 1991	G	Petition for writ of certiorari filed.
2	Jul 29 1991		Brief of respondents Therese Burke, et al. in opposition filed.
3	Jul 31 1991		DISTRIBUTED. September 30, 1991
4	Aug 8 1991	X	Reply brief of petitioner United States filed.
5	Oct 7 1991		Petition GRANTED.
			**********
6	Oct 17 1991	G	Motion of the Solicitor General to dispense with printing the joint appendix filed.
7	Nov 4 1991		Motion of the Solicitor General to dispense with printing the joint appendix GRANTED.
8	Nov 20 1991		SET FOR ARGUMENT TUESDAY, JANUARY 21, 1992. (1ST CASE)
9	Nov 21 1991		Brief of petitioner United States filed.
10	Nov 26 1991		Record filed.
		*	Partial proceedings and briefs United States Court of Appeals for the Sixth Circuit (1 Volume).
11	Nov 27 1991		CIRCULATED.
12	Dec 16 1991		Record filed.
		*	Certified record United States District Court, Eastern District of Tennessee.
14	Dec 20 1991	X	Brief amici curiae of American Civil Liberties, et al. filed.
17	Dec 20 1991	X	Brief amicus curiae of Equal Employment Advisory Council filed.
13	Dec 23 1991	X	Brief amicus curiae of National Employment Lawyers Association filed.
15	Dec 23 1991	X	Brief amicus curiae of American Association of Retired Persons filed.
16	Dec 23 1991	X	Brief amici curiae of Women Employed, 9 To 5, et aL. filed.
18	Dec 23 1991	X	Brief amicus curiae of National Women's Law Center filed.
19	Dec 23 1991	X	Brief amicus curiae of Equal Rights Advocates, Inc. filed.
20	Dec 23 1991	X	Brief of respondents Therese Burke, et al. filed.
22	Dec 26 1991	X	Brief amicus curiae of United Air Lines Pilot Group filed.
21	Jan 13 1992	X	Reply brief of petitioner United States filed.
23	Jan 21 1992		Argued

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No.

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In the Supreme Court of the United States

OCTOBER TERM, 1991

UNITED STATES OF AMERICA, PETITIONER

v.

THERESE A. BURKE, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED

Whether payments received in settlement of back-wage claims under Title VII of the Civil Rights Act of 1964 are excluded from the claimant's gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)).

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In the Supreme Court of the United States

OCTOBER TERM, 1991

No.

UNITED STATES OF AMERICA, PETITIONER

v.

THERESE A. BURKE, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-17a) is reported at 929 F.2d 1119. The opinion of the district court (App., *infra*, 18a-34a) is unofficially reported at 90-1 U.S.T.C. ¶ 50,203.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 35a-36a) was entered on April 5, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 104 of the Internal Revenue Code, 26 U.S.C. 104, provides in pertinent part:

Compensation for injuries or sickness

(a) **In general.**

Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

* * * * *

(2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness;

* * * * *

STATEMENT

1. Respondents are employees of the Tennessee Valley Authority (TVA) and members of the Office and Professional Employees International Union, AFL-CIO (OPEIU).[1] In 1984, Judy Hutcheson, a TVA employee, filed an action alleging that TVA had engaged in unlawful sex discrimination in the payment of salaries, in violation of Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e *et seq.* OPEIU intervened in the action in its representational capacity on behalf of respondents and other employees of TVA. App., *infra*, 2a.

Hutcheson and OPEIU alleged that TVA discriminated against female employees in 1981 when it increased the salaries of employees in male-dominated

[1] Respondents are Therese A. Burke, Cynthia R. Center, and Linda G. Gibbs.

pay schedules and either left salaries of employees in female-dominated pay schedules unchanged or lowered them (App., *infra*, 2a-3a). The complaint alleged that TVA had "a policy and practice of unlawful, gender-based discrimination with respect to salary" and that its conduct was "intended to and did result in disparate treatment of its female employees in their rates of pay in violation of Title VII of the Act" (*id.* at 20a, 22a). The plaintiffs sought an order restraining further discrimination and "a further order awarding back pay to all affected female employees * * * in an amount * * * sufficient to eliminate discrimination" (*id.* at 3a, 22a).

TVA filed a counterclaim against OPEIU alleging fraud, misrepresentation, breach of contract, and interference with contractual relationships. After the plaintiffs' claim and TVA's counterclaim survived motions for summary judgment, the parties settled the case. App., *infra*, 3a. Pursuant to the settlement, TVA agreed to pay $4,200 to Hutcheson and a total of $5,000,000 to affected TVA employees under a formula based on length of service and rates of pay (*id.* at 3a, 23a).[2] It was stipulated, however, that TVA would distribute the settlement funds to individuals only after it first withheld all applicable federal income taxes and FICA (social security) taxes from the payments (*id.* at 25a).[3]

[2] The settlement agreement provides that settlement payments are to be made to all affected persons who were employed "at any time between June 28, 1981, through and including March 10, 1987" (App., *infra*, 25a). The agreement further provides that the amounts to be paid to the affected employees "will be based upon pay rates and length of service * * * during the above period" (*id.* at 23a).

[3] The settlement agreement provides that "TVA will pay at OPEIU's direction a sum not to exceed $5,000,000, less any

Based upon their lengths of service and rates of pay, respondents Burke, Carter and Gibbs were entitled to receive, respectively, $764.94, $927.55, and $572.95 under the settlement agreement. TVA withheld federal income tax and FICA tax from these amounts and remitted the taxes to the United States. App., *infra*, 25a. The net balance of the settlement amounts was then paid to respondents (*id.* at 4a).

2. Respondents filed claims for refund with the Internal Revenue Service for the taxes withheld from the settlement payments. The Internal Revenue Service disallowed the claims. Respondents then commenced this refund action in the United States District Court for the Eastern District of Tennessee, claiming that the settlement payments should be excluded from their gross incomes under Section 104 (a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)). The district court rejected respondents' claims (App., *infra*, 18a-34a). The court observed that several courts have held that Title VII back pay awards do not constitute damages for "personal injuries or sickness" (*id.* at 31a-34a, citing, *e.g.*, *Thompson* v. *Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989); *Hodge* v. *Commissioner*, 64 T.C. 616, 618-620 (1975)) and that the complaint in the underlying Title VII action "makes it clear that the very core of the case was the recovery of wage deficiencies" (App., *infra*, 32a). Finding that the plaintiffs had "tacitly accepted that the sums to be received under the Settlement Agreement were in the nature of back pay" (*id.* at 34a), the court concluded that the amounts received by respondents were not excludable from gross income under Section 104(a)(2) (App., *infra*, 34a).

3. A divided court of appeals reversed (App., *infra*, 1a-17a). The panel majority stated that the question "whether the § 104(a)(2) exclusion applies requires an examination of the nature of the injury to determine whether the injury and claim are personal and tort-like in nature" (*id.* at 6a). The court concluded that a sex discrimination claim is "tort-like in nature" because "injuries resulting from invidious discrimination, be it on the basis of race, sex, national origin or some other unlawful category, are injuries to the individual rights and dignity of the person" (*ibid.*). The court of appeals had previously held in *Pistillo* v. *Commissioner*, 912 F.2d 145 (6th Cir. 1990), that an award of back pay under the Age Discrimination in Employment Act of 1967, 29 U.S.C. 621 *et seq.*, constituted damages for "personal injuries or sickness" to be excluded from income under Section 104(a)(2). The court found no basis for distinguishing *Pistillo* from the present case (App., *infra*, 7a-11a) and thus concluded that "suits for unlawful discrimination under Title VII, like suits under the ADEA and other tort type suits, fall within the category of suits for injury to the person and that the damages resulting therefrom are properly excludable under § 104(a)(2)" (*id.* at 11a).

In dissent (App., *infra*, 12a-17a), Judge Wellford observed that "[t]he subject matter of the [underlying Title VII] suit was pay for work performed" (*id.* at 12a) and that respondents "obviously recovered amounts which would have been subject to income tax had they come to [respondents] in the normal course" (*id.* at 14). Judge Wellford noted (*id.*

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taxes which TVA may be required to pay because it is the employer of any person whom OPEIU may designate to receive a portion of said sum" (App., *infra*, 25a).

at 15a) that the Fourth Circuit had held in *Thompson* v. *Commissioner*, 866 F.2d 709 (1989), that a Title VII back pay award is not excludable under Section 104(a)(2) because "[t]he back pay award was simply recovery for earned, but unpaid, wages" and represented "compensation for services rendered" (866 F.2d at 712). Because Judge Wellford found the Fourth Circuit's analysis of this issue to be "both logical and compelling," he concluded that the "flawed analysis" of *Pistillo* should not be extended to this case (App., *infra*, 15a).

REASONS FOR GRANTING THE PETITION

The holding in this case that back pay awards under Title VII of the Civil Rights Act of 1964 are to be excluded from a taxpayer's gross income as "damages received * * * on account of personal injuries," within the meaning of Section 104(a)(2) of the Internal Revenue Code, directly conflicts with the decision of the Fourth Circuit in *Thompson* v. *Commissioner*, 866 F.2d 709 (1989). See also *Johnston* v. *Harris County Flood Control District*, 869 F.2d 1565, 1580 (5th Cir. 1989) (an award of back pay under Title VII "is not tax exempt"), cert. denied, 110 S. Ct. 718 (1990). The issue addressed in this case affects many thousands of individuals who have received, or who will receive in the future, back pay under Title VII and under other employment discrimination statutes. Unless the conflict is resolved by this Court, these individuals will receive disparate tax treatment based entirely upon the happenstance of their geographical location.

1. Section 104(a)(2) of the Code provides that gross income does not include "the amount of any damages received (whether by suit or agreement

* * *) on account of personal injuries or sickness." This provision was first enacted as Section 213(b)(6) of the Revenue Act of 1918, ch. 18, 40 Stat. 1066, to implement this Court's holding in *Doyle* v. *Mitchell Brothers Co.*, 247 U.S. 179, 183, 185 (1918), that amounts received from the "conversion" of capital assets into money represented "income" only to the extent that a "gain" was realized from the transaction. "Applying this decision, the Attorney General held in an opinion, dated June 27, 1918, that the proceeds of an accident insurance policy were not subject to tax, the conclusion being based upon the reasoning that the human body is a kind of capital and that the proceeds of the insurance policy represented a conversion of capital lost through injury." S. 1384, 2 C.B. 71, 72 (1920) (citing 31 Op. Att'y Gen. 304 (1918)). The rationale for the statute, which "intended to go no further" (S. 1384, 2 C.B. at 72), was thus that the type of harm to the human body that gives rise to recoveries of workmen's compensation or health insurance payments, or to damage awards for "such injuries or sickness," did not represent "income" as the term was then defined. H.R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1918).[4] In the first ruling issued by the Internal

[4] Congress enacted Section 213(b)(6) because "[u]nder the present law it is doubtful whether [amounts received from health insurance, workmen's compensation or as damages on account of personal injuries] are required to be included in gross income." H.R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1918). The Treasury initially had taken the position that amounts paid under accident insurance policies and amounts received in a suit for personal injury were includable in income (T.D. 2135, 17 Treas. Dec. Int. Rev. 39 (1915)) but then changed its view and ruled that "the proceeds of an accident insurance policy received by an individual on account

Revenue Service under this statute,[5] it was therefore concluded that, while non-physical injuries (such as alienation of affections) could be regarded in some sense as "personal" injuries, they are nonetheless not within the statutory exclusion from income because "the term 'personal injuries,' as used therein means physical injuries only." S. 1384, 2 C.B. at 71; see *id.* at 72.[6]

In 1922, however, only two years after its first ruling, the Service reconsidered whether recoveries for alienation of affections (and other non-physical injuries to personal rights) were taxable and ruled that, while they are not excluded from income by (what is now) Section 104(a)(2), they nonetheless do not represent "income" because, when an individual receives damages that merely compensate him for loss suffered to a "personal right," "it cannot be held that he thereby derives any gain or profit." S. 132, I-1 C.B. 92, 93 (1922) (citing *Eisner* v. *Macomber*, 252 U.S. 189 (1920)). Because there is no gain or

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of personal injuries sustained by him through accident" and "an amount received by an individual as the result of a suit or compromise for personal injuries sustained by him through accident" were *not* income (T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918)).

[5] The Internal Revenue Service was known at that time as the Bureau of Internal Revenue. For continuity of discussion, however, this petition refers to both the Bureau of Internal Revenue and the Internal Revenue Service as "the Service."

[6] While the Service thus rejected a claim that the tort of alienation of affections represented a "personal injury" within the scope of the statute, the Service recognized that "it is still possible that damages therefor might be measured in part by sickness resulting therefrom and, of course, the amount received on account of sickness would be exempt under the express language of the statute." S. 1384, 2 C.B. at 72.

profit in such compensation, such recoveries were thought not to represent "income within the meaning of the sixteenth amendment and the statutes enacted thereunder." I-1 C.B. at 93-94. Even though the exclusion from income afforded to compensation for "personal injuries or sickness" under (what is now) Section 104(a)(2) was not deemed applicable to compensation received for a non-physical injury to personal rights, the Service thus ruled that such compensation was not taxable because no "income" had resulted. I-1 C.B. at 93-94.

In 1955, however, this Court made clear that the term "income" is not limited to earnings and profits from labor and capital but includes all "accessions to wealth" from whatever source derived. See *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). As a result, there is now no constitutional impediment to taxing personal injury damages. B. Bittker & L. Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 13.1.1, at 13-2 (2d ed. 1989). In *Glenshaw Glass*, however, the Court did not reject the Service's long-standing position that the recovery of damages for personal claims would not represent "income" under the Internal Revenue Code to the extent that such recoveries "correspond to a return of capital." 348 U.S. at 432 n.8, citing, *e.g.*, S. 132, I-1 C.B. at 92. Since the decision in *Glenshaw Glass*, the proper focus for the inquiry whether recoveries for non-physical injuries to personal rights are subject to tax is thus whether the recovery merely represents compensation, without "any gain or profit" (S. 132, I-1 C.B. at 93), for human "capital lost through injury" (S. 1384, 2 C.B. at 72). See *Commissioner* v. *Miller*, 914 F.2d 586, 590 (4th Cir. 1990); *Starrels* v. *Commissioner*, 304

F.2d 574, 576 (9th Cir. 1962) (Browning, J.) (the burden is on the taxpayer to establish that the recovery merely "restore[s] a loss of [personal] capital").[7]

The current judicial disagreement as to whether monetary recoveries for sex discrimination in the workplace are excluded from income by Section 104 (a)(2) is more easily resolved once the question is viewed from this proper historical perspective. See note 6, *supra*. Under the rationale that no "gain or profit" is realized when compensation is received for human "capital lost through injury," it is appropriate (for example) to recognize no taxable income from a recovery for defamation of one's character or for injury to one's "personal reputation." See, *e.g.*, *Hawkins* v. *Commissioner*, 6 B.T.A. 1023, 1024-1025 (1927). The receipt of monetary compensation in exchange for such lost "personal capital," which

[7] In 1983, the Ninth Circuit held in a case involving defamation that both physical and non-physical injuries are encompassed within the Section 104 exclusion. See *Roemer* v. *Commissioner*, 716 F.2d 693, 697. See also App., *infra*, 5a (adopting same reasoning). The only support offered for this holding in *Roemer* was that the 1922 Solicitor's Opinion had concluded that recoveries for non-physical injuries did not represent "income." See 716 F.2d at 697. As we have shown, however, the 1922 Solicitor's Opinion had instead observed that non-physical injuries were not encompassed within the statutory exclusion but were nonetheless not taxable to the extent that they merely compensate for a loss to human capital and represent no gain or profit. See S. 132, I-1 C.B. at 92. Although the Service has not formally acquiesced in *Roemer*, it no longer contends that only physical injuries are encompassed within Section 104. Instead, the focus of the inquiry is whether the nature of the recovery for a claim of non-physical injury compensates for a personal loss or represents an economic gain. See *Commissioner* v. *Miller*, 914 F.2d at 590.

merely makes "the plaintiff whole as before the injury" (*id.* at 1025), represents a transaction without gain or profit. *Ibid.* See *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 432 n.8 ("[d]amages for personal injury are by definition compensatory only"). It is not supportable, however, to view the receipt of back wages (which would have been taxed as income if received currently during the course of actual employment) as compensation for lost "personal capital". Back wages do not compensate for a loss, but represent an "undeniable accession to wealth" (*id.* at 431) for the recipient. See Rev. Rul. 72-341, 1972-2 C.B. 32 (Title VII back pay award is includable in gross income); Rev. Rul. 75-64, 1975-1 C.B. 16 (back pay awarded under the National Labor Relations Act is includable in gross income); Rev. Rul. 72-268, 1972-1 C.B. 313 (amounts awarded as overtime compensation and unpaid minimum wages under the Fair Labor Standards Act are includable in gross income). To hold otherwise is to introduce into the tax law the anomaly that wages promptly received for work performed are taxable, while later-received increments prescribed by law as part of those wages are not taxable.

2. a. In the present case, respondents received payments from their employer as part of a settlement of an action brought under Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e *et seq.* The Title VII action was based on an allegation that the manner in which the employer established salary schedules for different job categories resulted in gender discrimination in the payment of salaries. App., *infra*, 2a, 19a-20a. The only monetary relief sought in the underlying Title VII action, and the

only relief available in that action, was back pay.[8] Successful plaintiffs in a Title VII action may recover back pay in the amount of the differential between the salary received and the salary that would have been paid but for the discrimination (see *Rasimas* v. *Michigan Dep't of Mental Health*, 714 F.2d 614, 626 (6th Cir. 1983), cert. denied, 466 U.S. 950 (1984)), which is precisely what the plaintiffs sought here.[9] Because Title VII allows only "equitable" relief, however, it is well settled that general compensatory damages and punitive damages are not available under Title VII. *Walker* v. *Ford Motor Co.*, 684 F.2d 1355, 1363-1364 (11th Cir. 1982); *DeGrace* v. *Rumsfeld*, 614 F.2d 796, 808 (1st Cir. 1980). See *Patterson* v. *McLean Credit Union*, 491 U.S. 164, 182 n.4 (1989).

[8] Amounts received in settlement of a claim are treated for tax purposes as having the same character as the claim itself. *E.g.*, *Elrick* v. *Commissioner*, 485 F.2d 1049, 1058 (D.C. Cir. 1973); *Commissioner* v. *Murdoch*, 318 F.2d 414, 416 (3d Cir.), cert. denied, 375 U.S. 879 (1963); see *Lyeth* v. *Hoey*, 305 U.S. 188, 196 (1938) (amount received by taxpayer in settlement of will contest is treated in same manner as if "the contest had been fought to a finish and petitioner had succeeded").

[9] Some Title VII plaintiffs can recover an award of future lost earnings, *i.e.*, front pay, but this remedy generally is used only in cases where the employee-plaintiff was discharged and the statutory remedy of "reinstatement" (42 U.S.C. 2000e-5(g)) is not feasible. See, *e.g.*, *Shore* v. *Federal Express* Corp., 777 F.2d 1155, 1158-1160 (6th Cir. 1985). Since the court in a Title VII salary discrimination case can order the defendant to pay a non-discriminatory salary in the future, an award of front pay would seldom be appropriate. In any event, the plaintiffs here did not seek front pay, so no part of the settlement could represent front pay. A Title VII plaintiff can also recover a monetary award to account for lost fringe benefits such as vacation pay and pension benefits. See, *e.g.*, *Rasimas* v. *Michigan Dep't of Mental Health*, 714 F.2d at 626. The plaintiffs did not seek any such fringe benefits here. In any event, fringe benefits are not damages for personal injuries.

An award of back pay under Title VII thus does not constitute a recovery of "damages" that compensates for a personal loss. A demand for back pay under Title VII "is not in the nature of a claim for damages, but rather is an integral part of the statutory equitable remedy." *Johnson* v. *Georgia Highway Express, Inc.*, 417 F.2d 1122, 1125 (5th Cir. 1969). See also *Robinson* v. *Lorillard Corp.*, 444 F.2d 791, 802 (4th Cir.), cert. denied, 404 U.S. 1006 (1971). Since a back pay award is not an award of damages that compensates for an injury to one's personal capital, but represents an "undeniable accession to wealth" in the form of deferred wages from services actually provided, it represents taxable income under *Glenshaw Glass* and the Service's consistent rulings. See 348 U.S. at 432 n.8; Rev. Rul. 72-341, *supra*.[10] See also *Social Security Board* v.

[10] The principle of compensation in the common law of torts is "that a person should be compensated fairly for injuries caused by the violation of his legal rights." *Carey* v. *Piphus*, 435 U.S. 247, 257 (1978). Accordingly, mental and emotional distress caused by such a violation are compensable. *Id.* at 264. See *Memphis Community School District* v. *Stachura*, 477 U.S. 299, 307 (1986) (compensatory damages may include "such injuries as 'impairment of reputation . . ., personal humiliation, and mental anguish and suffering'" (quoting *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 350 (1974))). Yet compensatory damages for mental and emotional distress are not available under Title VII. See *DeGrace* v. *Rumsfeld*, 614 F.2d 796, 808 (1st Cir. 1980). The unavailability of tort-like remedies further indicates that a Title VII action is not an "action based upon tort or tort type rights" (Treas. Reg. § 1.104-1(c)), and that a back pay award under Title VII does not constitute damages for personal injuries excludable from income under Section 104(a)(2).

Nierotko, 327 U.S. 358, 363-366 (1946) (back pay awarded under the National Labor Relations Act represents taxable "wages" for purposes of the Social Security Act).

b. The injury suffered by respondents (and the injury for which they were compensated under Title VII) was an injury to their economic interests relating to the amount of their salaries. See *Albemarle Paper Co.* v. *Moody*, 422 U.S. 405, 418 (1975) ("Title VII deals with legal injuries of an economic character"). In concluding that Title VII back pay does not constitute damages for personal injuries excludable under Section 104(a)(2), the Fourth Circuit observed in *Thompson* v. *Commissioner*, 866 F.2d at 712, that a Title VII back pay award is "simply recovery for earned, but unpaid, wages" and represents "compensation for services rendered."[11] The Tax Court had earlier reached that same conclusion in *Hodge* v. *Commissioner*, 64 T.C. 616, 619

[11] The taxpayer in *Thompson* received a back pay award under Title VII and the Equal Pay Act of 1963, 29 U.S.C. 206(d). See 866 F.2d at 710-711. The Equal Pay Act generally prohibits gender discrimination in the payment of salaries to employees doing equal work. Title VII's prohibition of employment discrimination is, of course, much broader than the "equal pay for equal work" requirement of the Equal Pay Act. The salary discrimination suffered by the taxpayer in *Thompson* was proscribed by both statutes. A prevailing employee is entitled to relief under both statutes so long as she does not receive overlapping relief for the same wrong. *Laffey* v. *Northwest Airlines, Inc.*, 567 F.2d 429, 445 (D.C. Cir. 1976), cert. denied, 434 U.S. 1086 (1978). Although the Fourth Circuit primarily referred to the Equal Pay Act in its discussion of why the back pay award was not excludable under Section 104(a)(2) (see 866 F.2d at 712), it recognized that the taxpayer also received back pay under Title VII and that the issue presented was "whether an award of back pay under the Equal Pay Act and Title VII * * * [is] excludable under section 104(a)(2)" (*id.* at 711).

(1975), observing that "[u]se of the adjective 'back' in the phrase 'back pay' indicates a recovery of wages which should have been paid but were not."[12] Wages are, of course, includable in an employee's gross income under Section 61(a)(1) of the Internal Revenue Code as "[c]ompensation for services." 26 U.S.C. 61(a)(1). The Fourth Circuit in *Thompson* thus correctly concluded that Title VII back pay represents wages that are includable in gross income rather than damages for a personal injury. See 866 F.2d at 712.

The conclusion of the Fourth Circuit in *Thompson* and the Tax Court in *Hodge* that Title VII back pay is not to be excluded from income is wholly in accord with the policies fostered by Title VII. The remedies available under Title VII are designed "to make persons whole for injuries suffered on account of unlawful employment discrimination." *Albemarle Paper Co.* v. *Moody*, 422 U.S. at 418. A Title VII back pay award is thus designed to place the employee in the same economic position that she would have achieved had she not been discriminated against in the first place. If the employer had not discriminated against respondents in the present case, they would have received higher salaries, and those salaries would have been included in their gross incomes. Requiring respondents to pay taxes on their back pay

[12] The Tax Court has followed its decision in *Hodge* in several other cases holding that Title VII back pay is not excludable under Section 104(a)(2). *Thompson* v. *Commissioner*, 89 T.C. 632, 644-648 (1987), aff'd, 866 F.2d 709 (4th Cir. 1989); *Sparrow* v. *Commissioner*, 57 T.C.M. (CCH) 816, 819-821 (1989), appeal pending, No. 90-1151 (D.C. Cir.); *Coats* v. *Commissioner*, 36 T.C.M. (CCH) 1650 (1977). The Court of Claims has also held that Title VII back pay is not excludable under Section 104(a)(2). *Watkins* v. *United States*, 80-1 U.S.T.C. ¶ 9362 (Ct. Cl. 1980).

awards under Title VII simply puts them in the same position they would have held if they had not been discriminated against in the first place. See *Thompson* v. *Commissioner*, 866 F.2d at 712 ("[i]f the back pay award were excluded from gross income, Thompson would be placed at an advantage over her male co-workers, who presumably reported their total earned wages as gross income").

c. The decision in the present case conflicts directly with the Fourth Circuit's decision in *Thompson* v. *Commissioner* and with the holding of the Fifth Circuit in *Johnston* v. *Harris County Flood Control District* that back pay under Title VII "is not tax exempt" (869 F.2d at 1580).[13] The decision in the present case is, however, consistent with prior decisions of the Third and Sixth Circuits that held that back pay awards under the Age Discrimination in Employment Act, 29 U.S.C. 621-634 (ADEA), constitute damages for personal injuries that are excluded from income under Section 104(a)(2). *Pistillo* v. *Commissioner*, 912 F.2d 145 (6th Cir. 1990); *Rickel* v. *Commissioner*, 900 F.2d 655 (3d Cir. 1990).[14] Although we disagree with the conclusions reached in

[13] In addition, in *Sears* v. *A.T. & S.F. Ry.*, 749 F.2d 1451, 1456 (10th Cir. 1984), cert. denied, 471 U.S. 1099 (1985), the court of appeals concluded that back pay awarded under Title VII is subject to tax and therefore allowed the award to be enhanced so that the employees would be in the same after-tax position they would have been in if the correct wages had been paid currently by the employer.

[14] In *Pistillo* and *Rickel*, the courts of appeals reversed Tax Court decisions holding that ADEA back pay was not excluded from income under Section 104(a)(2). *Pistillo* v. *Commissioner*, 57 T.C.M. (CCH) 874, 979-881 (1989), rev'd, 912 F.2d 145 (6th Cir. 1990); *Rickel* v. *Commissioner*, 92 T.C. 510, 521-522 (1989), rev'd, 900 F.2d 655 (3d Cir. 1990).

Pistillo and *Rickel*, we agree with the court of appeals that there is no valid basis for distinguishing the tax treatment of back pay under Title VII and under the ADEA (App., *infra*, 9a).

3. The question presented in this case has substantial recurring administrative importance because it affects the thousands of individuals who have received or will receive back pay under Title VII or under other federal employment discrimination statutes, such as the Age Discrimination in Employment Act and the Equal Pay Act.[15] The question of the proper income tax treatment of such back pay also has important collateral consequences in Title VII litigation. The Service has long ruled that Title VII back pay is to be included in gross income and that it constitutes "wages" subject to income tax withholding and FICA (social security) taxes. Rev. Rul. 72-341, 1972-2 C.B. 32. Courts in Title VII cases have taken into account the fact that back pay will be included in the recipient's gross income in fashioning the back pay award.[16] The question whether Title VII back pay is excluded from gross income

[15] In 1989, Congress added a new provision to Section 104(a) that states that the Section 104(a)(2) exclusion "shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness." Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7641(a), 103 Stat. 2379. Since this provision applies only to punitive damages, which are not available under Title VII, the question presented in this case remains unaffected by the amendment.

[16] See note 13, *supra*; *Melani* v. *Board of Higher Education*, 652 F. Supp. 43, 48 (S.D.N.Y. 1986), aff'd mem., 814 F.2d 653 (2d Cir. 1987) (Table). See also *Gelof* v. *Papineau*, 829 F.2d 452, 455 (3d Cir. 1987) (ADEA back pay).

under Section 104(a)(2) thus has substantial continuing importance in Title VII litigation.[17]

In the absence of a decision from this Court resolving the conflict among the courts of appeals, the tax treatment of back pay awards, as well as the amount of the awards themselves, will differ based solely upon the happenstance of geography. Resolution of this recurring issue is needed to avoid continuing uncertainty and uneven application of the revenue laws and of the remedies under Title VII and other employment discrimination statutes.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JULY 1991

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[17] In addition, employers need clarification of whether they are to withhold income and FICA taxes from back pay awarded under Title VII, as the Service's instructions require (see Rev. Rul. 72-341, 1972-2 C.B. 32), or whether such awards are exempt from tax and withholding requirements.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 90-5607

THERESE A. BURKE, CYNTHIA R. CENTER, LINDA G. GIBBS, PLAINTIFFS-APPELLANTS

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

On Appeal from the United States District Court for the Eastern District of Tennessee

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Decided and Filed April 5, 1991

Before: MERRITT, Chief Judge; JONES, Circuit Judge; and WELLFORD, Senior Circuit Judge.*

JONES, Circuit Judge, delivered the opinion of the court, in which MERRITT, Chief Judge, joined.

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* The Honorable Harry W. Wellford assumed senior status on January 21, 1991.

WELLFORD, Senior Circuit Judge, (pp. 11-16), delivered a separate dissenting opinion.

JONES, Circuit Judge. Three taxpayers, Therese A. Burke, Cynthia R. Center, and Linda Gibbs, appeal the decision of the district court that funds distributed to them as part of a settlement agreement resulting from an action under Title VII alleging sex discrimination were not excludable as "damages received on account of personal injuries or sickness" under 26 U.S.C. § 104(a)(2). As we find that injuries sustained in violation of Title VII are "personal injuries," and that damages resulting from such injuries are excludable from taxation under § 104(a)(2), we reverse.

I.

Taxpayers brought this action seeking refunds of federal income taxes and social security taxes withheld from payments taxpayers received from their employer in settlement of a Title VII sex discrimination action. Taxpayers were employed by the Tennessee Valley Authority ("TVA") and were members of the Office and Professional Employees International Union ("the union"). In 1984, Judy A. Hutcheson, another TVA employee, filed a Title VII action in the district court against TVA alleging unlawful discrimination in the payment of salaries based upon gender. The union subsequently joined the action in its representational capacity on behalf of certain employees of TVA, including the three taxpayers in the instant case.

In their second amended complaint, Hutcheson and the union generally alleged that the TVA had discriminated against female employees when, in 1981, it had increased the salaries of employees in certain

male-dominated pay schedules but did not increase salaries of employees in certain female-dominated pay schedules. Moreover, TVA allegedly lowered salaries in some female-dominated schedules. Plaintiffs sought the following relief:

> Plaintiffs pray for judgment against defendants and for an order of this Court restraining and enjoining defendants from further discrimination against women in the SB schedule in wages and salaries and for a further order awarding back pay to all affected female employees in the SB schedule in an amount found to be just and proper sufficient to eliminate discrimination, for costs and for attorney's fees, and for such other relief as may be warranted in the premises.

J. App. at 33-34.

TVA filed a counterclaim against the union alleging fraud, misrepresentation, breach of contract, conspiracy with intent to defraud TVA and interference with contractual relationships. This counterclaim sought damages in the range of $30,000,000.00 (including treble and punitive damages). After both parties' claims survived cross motions for summary judgment, the parties decided to settle. The settlement agreement ("settlement") provided for the dismissal of TVA's counterclaim; a direct payment of $4200.00 to plaintiff Hutcheson; the conduct of a new regional salary survey; an amendment to the TVA/Union bargaining agreement to provide a method of salary arbitration for the future; and a lump sum payment of $5,000,000.00 to be distributed "at [the union's] discretion." Later the union asserted that distribution of the funds to the more than 8000 anticipated recipients was administratively unfeasible.

Thus, an amended settlement agreement was entered into which provided that TVA would distribute the money directly to individuals designated by the union under a formula established by the union.

The formula established by the union took into consideration length of service in the affected salary schedule and rates of pay. TVA agreed to distribute the money, but only on the condition that it could withhold federal income tax and FICA tax from the payments. The union reluctantly agreed and the money was distributed. It is important to note that TVA did not tax its direct payment of $4,200.00 to Hutcheson. Nor did TVA tax the monies left over as undeliverable to named individuals which were turned over to the union. Further, those funds, when distributed by Union to other employees, were not taxed.

On December 6, 1988, Betty K. Adkins, Cathy Elaine Adkins, Edward Bailey and "more than 1,000 other persons" filed the instant tax refund action. Later plaintiffs filed a motion to amend their complaint and dismiss without prejudice all the plaintiffs except the three taxpayers named in this action. The motion was granted and the present action ensued.

II.

This appeal raises the question of whether damages received in a settlement agreement in a Title VII action for sex discrimination are excludable as damages for "personal injury" under Internal Revenue Code § 104(a)(2). Whether the lower court properly applied § 104(a)(2) to disputed funds is a question of law and reviewed *de novo*. *Threlkeld v. Commissioner*, 848 F.2d 81, 83 (6th Cir. 1988) (citing *Roemer v. Commissioner*, 716 F.2d 693, 696 (9th Cir. 1983)).

As a general rule, under the Internal Revenue Code, "gross income means all income from whatever source derived." 26 U.S.C. § 61(a). Thus, all accessions of wealth are presumed to be "gross income" unless the taxpayer can show that the accession falls within a specific exclusion under the I.R.C. *See Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430 (1955). Section 104(a)(2) provides that "gross income does not include . . . the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness. . . ." Several courts have held that for the purpose of § 104(a)(2), "personal injuries" means both physical and nonphysical injuries. *See Pistillo v. C.I.R.*, 912 F.2d 145, 148 (6th Cir. 1990) (injury involved age discrimination); *Rickel v. Commissioner*, 900 F.2d 655, 658 (3rd Cir. 1990) (age discrimination); *Bent v. Commissioner*, 835 F.2d 67, 70 (3rd Cir. 1987) (deprivation of first amendment rights); *Roemer v. Commissioner*, 716 F.2d 693, 697 (9th Cir. 1983) (defamation). Treasury regulations define a claim for personal injuries under § 104(a)(2) as one which is based upon "tort or tort-type rights." 26 C.F.R. § 1.104-1(c) (1990). Essentially, the "exclusion under § 104(a)(2) is that the income involved must derive from some sort of tort claim against the payor." *Glynn v. Commissioner*, 76 T.C. 116, 119 (1981).

We see the question presented to us in this appeal as a quite narrow one. In *Threlkeld v. Commissioner*, 87 T.C. 1294, 1299 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988), the entire tax court, in a 15-1 decision, held that the test for determining whether a specific damage award qualified for the § 104(a)(2) exclusion is as follows:

> Section 104(a)(2) excludes from income amounts received as damages on account of personal injuries. *Therefore, whether the damages received are paid on account of "personal injuries" should be the beginning and end of the inquiry. To determine whether the injury complained of is personal, we must look to the origin and character of the claim . . ., and not to the consequences that result from the injury.*

(emphasis added). In other words, determining whether the § 104(a)(2) exclusion applies requires an examination of the nature of the injury to determine whether the injury and claim are personal and tort-like in nature, and not whether the consequences of the injury resulted in an award of compensatory damages or damages for back pay. *See Pistillo v. C.I.R.*, 912 F.2d 145, 148-49 (6th Cir. 1990). Thus, our inquiry is limited to whether injuries resulting from sex discrimination in violation of Title VII are "personal injuries" for the purposes of § 104(a)(2).

Courts have long held that injuries resulting from invidious discrimination, be it on the basis of race, sex, national origin or some other unlawful category, are injuries to the individual rights and dignity of the person. *See, e.g. Goodman v. Lukens Steel Co.*, 482 U.S. 656, 661 (1986) (race discrimination, challenged under § 1981, is a fundamental injury to the individual rights of the person); *Thompson v. Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989) (sex discrimination is an injury to the person); *cf. Wilson v. Garcia*, 471 U.S. 261, 277 (1985) (analogizing a violation of the Civil Rights Act of 1871 to a violation of the fourteenth amendment which sounds in tort as in injury to the person); *Tillman v. Wheaton-Haven Recreation Ass'n*, 517 F.2d 1141, 1143 (4th

Cir. 1975) ("an action brought under statutes forbidding racial discrimination is fundamentally for the redress of a tort."); *Curtis v. Loether*, 415 U.S. 189, 195-96 n.10 (1974) (analogizing racial discrimination to a "dignitary tort."). This long-held view of the tort-like nature of the injury resulting from unlawful discrimination has led this court and others to the conclusion that damages resulting from an action for unlawful discrimination are "damages on account of personal injury" for the purposes of § 104(a)(2). *See, e.g. Pistillo v. C.I.R.*, 912 F.2d 155 (6th Cir. 1990) (injuries resulting from age discrimination in violation of the Age Discrimination in Employment Act are personal injuries for the purposes of § 104(a)(2); *Rickel v. Commissioner*, 900 F.2d 655, 662 (3rd Cir. 1990) (age discrimination is a tort-like personal injury for the purposes of § 104(a)(2)); *Metzger v. Commissioner*, 88 T.C. 834 (1987), *aff'd without opinion*, 845 F.2d 1013 (3rd Cir. 1988) (finding that damages pursuant to settlement agreement reached in sex and national origin discrimination suit based upon 42 U.S.C. §§ 1981, 1983, 1985(3), 1986 and 2000e, et seq. (Title VII) were damages for "personal injury" under § 104).

The government asks us to draw a distinction between injuries resulting from discrimination in violation of Title VII and other forms of discrimination that this and other courts have found to be personal injuries for the purposes of § 104(a)(2). In support of its position, the government argues that Title VII only provides for back pay damages, *Boddy v. Dean*, 821 F.2d 346, 352 (6th Cir. 1987) (Title VII does not provide for compensatory or punitive damages), and that the intent of those damages is to make the plaintiff economically whole, *Shore v. Federal Express*

Corp., 777 F.2d 1155, 1158-59 (6th Cir. 1985) (Title VII damages are to make plaintiffs whole for past discrimination by restoring the economic position plaintiff would have occupied absent discrimination). Thus, the government argues that since back pay damages simply compensate plaintiffs for income they would have received absent the discrimination, these awards are economic rather than "tort or tort type" damages and therefore, not excludable under § 104. *See Hodge v. Commissioner*, 64 T.C. 616, 620-21 (1975) (damages awarded for back pay in race discrimination suit are not excludable under § 104).

We find the government's position unconvincing because the government misapprehends the proper inquiry for determining excludability under § 104(a)(2). Contrary to the tax court's teaching in *Threlkeld*, the government focuses its analysis on the consequences of a Title VII violation (the payment of back pay for lost wages) rather than the personal nature of the injury (invidious discrimination). Our recent decision in *Pistillo* brings us a considerable distance toward resolution of the question before us. In *Pistillo*, the court considered whether settlement damages awarded in a suit for age discrimination under the ADEA, which sought back pay and reinstatement, were excludable under § 104(a)(2). The *Pistillo* court, reversing the tax court, found that damages awarded under the ADEA were "compensation for the *personal injury* [plaintiff] suffered as a result of his employer's invidious age discrimination." 912 F.2d at 150 (emphasis original). The court held, further, that "[plaintiff's] loss of wages—a substantial nonpersonal consequence of his employer's age discrimination—did not transform the discrimination into a nonpersonal injury." *Id.* Thus, the court held

that damages awarded in a settlement agreement under the ADEA were "damages for personal injury" excludable under § 104(a)(2).

Similarly, the court in *Rickel*, in rejecting the government's assertion that discrimination suits which sought damages for lost wages were based in contract rather than in tort as required by § 104 stated:

> [T]he duty of an employer to refrain from discrimination against employees on the basis of their age arises by operation of a statute. Society has made the moral and economic determination that as a matter of law it will not abide such discrimination. Such a duty arises even in the absence of a written employment contract and despite the existence of either contrary terms in such a contract or conflicting common law employment-at-will principles.

900 F.2d at 662. Thus, the *Rickel* court concluded that despite the fact that some of the compensation included in Rickel's settlement agreement was for back pay, the entire damage award was nonetheless excludable under § 104(a)(2). *Id.* at 664.

The government argues that excluding damages awards which include back pay from gross income for tax purposes will result in unfairness as employees will be better off than they would have been had the discrimination not occurred because the back pay award would not be subject to tax. While the government's position has some logical appeal, we have already addressed this concern in *Pistillo*:

> Given the result we reach today, Pistillo will have less federal tax liability than if he had not suffered age discrimination in the first place. The reality, however, as opposed to the hypothet-

> ical, is that Pistillo did suffer invidious age discrimination. Pistillo endured his employers' indignities, insults and age discrimination; suffered a dignitary tort; and was personally injured, . . . Pistillo is now entitled to receive federal tax treatment *equal* to that received by the typical tort victim who suffers physical injury and, as a result, receives a settlement award. *See Rickel*, 900 F.2d at 664 ("[T]he successful ADEA plaintiff is being treated no better . . . than the typical tort victim who suffers a physical injury. We see no reason to treat one personal injury victim any differently than another.").

Pistillo, 912 F.2d at 150 (emphasis original). Thus, a plaintiff who suffers the personal injury of discrimination and loses pay as a consequence will be treated identically to the victim of a physical injury whose damage award which includes lost wages is not taxable despite the fact that those wages would have been taxed had the injury not occurred. The fact that the settlement agreement in the instant case included a clause stating that the agreement was not an admission of discrimination, does not change the nature of the injury of discrimination or the logic of this court's analysis in *Pistillo*.

In sum, *Threlkeld* and its progeny require that for the purposes of § 104(a)(2), this court determine whether the injury is personal and the claim resulting in the damages is tort-like in nature. If the answer is in the affirmative, then that is "the beginning and end of the inquiry." *Threlkeld*, 87 T.C. at 1299. The damages resulting from such a claim are fully excludable under § 104(a)(2). At no point do we inquire into the nature of the damages involved.

Rather the narrow scope of our gaze is properly limited to the "origin and character of the claim, . . . and not to the consequences that result from the injury." *Threlkeld*, 87 T.C. at 1299. This court in *Pistillo* held that damages resulting from the settlement of an action for age discrimination under the ADEA were fully excludable as "damages on account of personal injury" under § 104(a)(2). The government has not provided, either in its briefs or in oral argument, and this court cannot discern, any principled way to distinguish the injuries arising from a claim for invidious age discrimination, and the claim for invidious sex discrimination before us today, except that these tort claims were brought under different federal statutes. In addition, the government was unable to demonstrate why injuries resulting from sex discrimination were not "personal" while other forms of non-physical tort injuries were "personal" for the purposes of § 104(a)(2) exclusion. *See, e.g., Threlkeld*, 87 T.C. at 1308, *aff'd* 848 F.2d 81 (6th Cir. 1988) (injuries to taxpayer's professional reputation due to a malicious prosecution excludable as personal under § 104(a)(2)); *Roemer*, 716 F.2d at 700 (compensatory damages received in a taxpayer's defamation suit were excludable as personal injuries under § 104(a)(2)); *Byrne v. Commissioner*, 883 F.2d 211, 216 (3rd Cir. 1989) (relying on *Bent* and *Roemer* to extend the § 104 exclusion to a retaliatory discharge claim under the Fair Labor Standards Act and a wrongful discharge claim under state law). Thus, we find that suits for unlawful discrimination under Title VII, like suits under the ADEA and other tort type suits, fall within the category of suits for injury to the person and that the damages resulting therefrom are properly excludable under § 104(a)(2).

Therefore, we hold that the withholding of federal taxes from the Title VII settlement damages giving rise to this taxpayer's action was improper. We REVERSE and REMAND for entry of an order consistent with this opinion.

WELLFORD, Senior Circuit Judge, dissenting:

I respectfully dissent from the reversal of the district court's decision in this case. The payments at issue received by plaintiffs should not be excludable from their gross income as determined by the district court.

Plaintiffs in their complaint specifically sought back pay allegedly denied them because of their sex. Plaintiffs' complaint referred at length to schedules of pay and asserted that classes of men allegedly doing work comparable to that done by plaintiffs received more pay for the allegedly comparable work. Presumably, the pay of these men was subject to income tax and FICA withholding. Plaintiffs sought, in short, equality of pay and then demanded back pay from TVA. The subject matter of the suit was pay for work performed, all subject presumably to the gross income definition of 26 U.S.C. § 61(a).

Plaintiffs claim that what they received was not equivalent to payment for services and thus not taxable, but the burden is upon them to show entitlement to an exclusion in light of the nature of their demand for *back pay*. *Commisisoner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). Plaintiffs claim that what they received was "damages" for "personal injuries," as in the case of *Pistillo v. Commissioner*, 912 F.2d 145 (6th Cir. 1990), rather than otherwise taxable earned income. I.R.C. § 104(a)(2).

Pistillo involved a jury award, later converted to settlement, including fees in an age discrimination case under 29 U.S.C. §§ 621-634.[1] The *Pistillo* plaintiffs' claim included (according to jury instructions) "liquidated damages, compensatory damages," and other benefits claimed to have been lost due to age discrimination. *Pistillo* relied, in part, upon *Wulf v. City of Wichita*, 883 F.2d 842 (10th Cir. 1989), a first amendment termination case; on *Bent v. Commissioner*, 835 F.2d 67 (3d Cir. 1987), which was based on a first amendment claim and only partially on a lost wages claim; and on *Roemer v. Commissioner*, 716 F.2d 693 (9th Cir. 1983), which dealt with defamation damages. I believe that *Wulf*, *Bent* and *Roemer* are not comparable to the present sex discrimination lost wages or comparable worth case. I find them clearly distinguishable.

Wulf and *Bent*, in the first place, involved *wrongful terminations* based upon free speech considerations, a far cry from the claim in this case which involves no termination and a straightforward wage differential demand. *Roemer* involved a claim for defamation, defined as a personal injury claim under California law. I conclude that it likewise has no applicability to the instant controversy.[2] *Pistillo*'s reasoning that an age discrimination award for a termination which arose out of violation of an "individual right" and therefore is not taxable as a "personal

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[1] *Pistillo* reversed a Tax Court decision which held the jury award amount to be taxable based upon substantial authority from other circiuts.

[2] *Byrne v. Commissioner*, 883 F.2d 211 (3d Cir. 1989), extended the *Bent* and *Roemer* rationale to a retaliatory discharge claim under FLRA, still in no way comparable to the circumstances here.

injury" extends an exception from income taxation further than any previous case which dealt with an ADEA claim. I would not extend this rationale to a wholesale exemption of a wage benefits distribution attributable to a claimed wage differential as in this controversy.

The struggle to distinguish recoveries for personal injuries from all other recoveries began with the recognition that not all personal injuries are physical. *Hawkins v. Commisisoner*, 6 B.T.A. 1023 (1927); *Roemer*, 716 F.2d 693. Even if one accepts a recent inclination of some courts to characterize awards and accessions to wealth as damages for personal injuries rather than income, one must examine carefully the distinctions in those cases from the factual circumstances, as in the case at bar, in which the taxpayer obviously recovered amounts which would have been subject to income tax had they come to the taxpayer in the normal course. The majority would now extend the proposition that we look only to see whether the plaintiff has suffered an injury to personal dignity as a basis for a back pay recovery. *See Pistillo*, 912 F.2d at 150.

In *Threlkeld v. Commissioner*, 87 T.C. 1294 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988), plaintiff claimed injury to professional reputation as part of a state law claim of malicious prosecution and the injury was measured by reference to lost business. The Tax Court determined that the recovery was due to a personal injury despite its link to economic ability. In reaching its decision the court stated that

> whether the damages received are paid on account of "personal injuries" should be the beginning and end of the inquiry. To determine whether the injury complained of is personal,

> we must look to the origin and character of the claim and not to the consequences that result from the injury.

87 T.C. at 1299 (citation omitted). The court did *not* say that all claims that include personal injury are necessarily fully about personal injury and therefore excludable from taxable income. It did *not* say that the consequences that flow from an injury are irrelevant to determining a claim's character and origin. To the contrary, the Tax Court in *Threlkeld* stated that the court

> must look to various factors, including the allegations in the . . . pleadings, the evidence adduced at trial, a written settlement agreement, and the intent of the payer. . . . Because of the multitude of situations involving the payment of damages for an allegedly personal injury, the most that can be said is that we will look to all of the facts and circumstances to determine whether the injury is, in fact, personal.

Id. at 1306.

The majority in the present case would extend what I feel is a flawed analysis in *Rickel v. Commissioner*, 900 F.2d 655 (3d Cir. 1990), and *Pistillo* beyond ADEA, again without critical analysis of the statute at issue. I find the analysis in *Thompson v. Commissioner*, 866 F.2d 709 (4th Cir. 1989), to be both logical and compelling:

> After analyzing the statutory scheme [of the Equal Pay Act and Title VII] we conclude that Thompson received the liquidated damages through prosecution of a tort-type claim for personal injuries. We conclude, however, that the claim for back pay was essentially a contractual

claim for accrued wages. Thus, the Tax Court correctly held the liquidated damages award excludable under section 104(a)(2), and the award of back pay includable in gross income.

. . . .

Thompson performed essentially the same work as her male co-workers for which she should have received equal pay. The back pay award was simply recovery for earned, but unpaid, wages which distinguishes her award of back pay from awards for lost wages or lost income in traditional personal injury/tort actions. She received compensation for services rendered whereas a tort plaintiff receives compensation for the inability to earn an income due to the tortious action of a defendant. *Threlkeld v. Commissioner*, . . . *Bent v. Commissioner*, 835 F.2d 67 (3d Cir. 1987), *Roemer v. Commissioner* . . . .

Id. at 712. This better reasoned analysis of the Fourth Circuit reveals that the term "contract" should be understood in a broad sense to include that which the Third Circuit in *Rachel* sought to exclude by rejecting the term "economic."

In *Metzger*, the Tax Court stated that its earlier decision in *Hodge v. Commissioner*, 64 T.C. 616 (1975), should not be read to imply that all recovery under Title VII is taxable but that the facts should be tested to determine the nature of a claim. 88 T.C. at 858. The court distinguished *Hodge* because the *Hodge* taxpayers received only back pay whereas that was not the case in *Metzger*. The court looked to the language in the settlement agreement, the underlying complaint and the evidence and arguments presented at trial to determine whether the recovery was meant to be back pay. 88 T.C. at 845-46. The court specifically stated that when a settlement agreement is not explicit about the character of a claim that factual evidence of the payor's intent is "most important" to determining the applicability of § 104. *Id.* at 857 (citing *Knuckles v. Commissioner*, 349 F.2d 610 (10th Cir. 1965)). It determined that the recovery was not back pay since there was no effort to calculate back pay and the settlement was meant to cover a number of claims not related to back pay.

The difference between the *Metzger* case and the case at bar seems apparent to me. Burke sought back pay in her complaint.[3] Payment under the settlement was linked to wages and taxes were withheld.[4] This is not a case in which back pay is a means of measuring loss due to a tort. Compensation for that loss, if it exists in this case, was not sought and arguably was not available under § 2000e. *See Boddy v. Dean*, 821 F.2d 346, 352 (6th Cir. 1987). Rather, this is a case in which the plaintiff "received in settlement [payment that] was includable in gross income because it was intended to compensate [Burke] for lost earnings. . . ." *Threlkeld*, 848 F.2d at 83 (distinguishing *Wolfson v. Commissioner*, 651 F.2d 1228 (6th Cir. 1981)). *See also Wolfson* (accepting applicability of clear error analysis to Tax Court determinations of excludability in personal injury cases).

I would AFFIRM the district court.

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[3] The complaint requested an injunction against further discrimination and an "order awarding back pay to all affected female employees . . . ."

[4] The majority opinion finds some significance in conduct, which it describes as (1) TVA not taxing its direct payment to Hutcheson; and (2) not taxing monies left over as undeliverable which were turned over to the union. Each check, however, clearly stated the amount *withheld as taxes* making the payor's intent clear.

APPENDIX B

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

CIV-1-88-508

THERESE A. BURKE, CYNTHIA R. CENTER, AND LINDA G. GIBBS, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

MEMORANDUM

[Filed Mar. 20, 1990]

This is a suit to obtain refunds from the Commissioner of Internal Revenue of various amounts of money withheld as income taxes and as Social Security (Federal Insurance Contributions Act, 26 U.S.C. §§ 3101 *et seq.* ("FICA")) assessments from damages paid to each plaintiff by the Tennessee Valley Authority ("TVA") in settlement of a prior law suit. The question presented is whether the damages were excludable from income under section 104(a)(2) of the Internal Revenue Code. The case has been submitted for decision on the record (*see* Court File Nos. 13 at 2; 15 at para. 2).

Findings of Fact

The plaintiffs in this case were employed by the Tennessee Valley Authority ("TVA") and were members of the Office and Professional Employees Inter-

national Union, AFL-CIO ("OPEIU"). The plaintiffs were beneficiaries of the relief sought in *Hutcheson v. Dean*, Civil Action No. 3-85-119 (E.D. Tenn.) ("*Hutcheson*"), filed by various TVA employees and the OPEIU against the TVA under Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e, *et seq.* (*see* Court File No. 15 at paras. 3, 8-9).[1] The complaint in *Hutcheson* made the following allegations:

> 11. As part of its salary and wage structure, . . . TVA maintains some six separate pay schedules for employees . . . . One of these schedules is known as and identified as the Clerical and General Services Schedules (SB), hereinafter referred to as the SB schedule. The SB schedule . . . is predominantly staffed by women . . . .
>
> 12. TVA maintains an Administrative Schedule (S), . . . an Engineering and Scientific Schedule (SD), . . . [and] an Aide and Technical Schedule (SE) . . . .
>
> 13. Schedules SA, SD, and SE are staffed predominantly by men . . . .
>
> 14. TVA maintains a Custodial Schedule (SF) . . . [and] a Public Safety Schedule (SG).

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[1] The plaintiffs in *Hutcheson* sought certification as a class action. The Court denied class certification, saying "the Court does not believe a class action is required in order to give the relief requested. The presence of OPEIU in this action insures that the interests of [the class] will be protected" (Court File No. 8, exhibit 3 at 4). The Court noted as well that it had another reason to deny class status: "it would be inequitable to give the relief requested only to *female* SB schedule employees. If discrimination has occurred against female employees, presumably the few male employees holding clerical positions have also suffered by their identification with the class" (*id.*).

. . . Both SF and SG schedules are staffed predominantly by men.

15. The number of women in the SB schedule greatly exceeds the total of men in the SB, SF, and SF schedules.

16. The number of men in the SA, SD, and SE schedules greatly exceeds the total or women in the SB schedule.

17. Plaintiffs bring this action on behalf of . . . all female SB schedule employees of TVA as of August 31, 1981, to the present. . . .

18. . . . Plaintiffs allege that there exists on the part of the TVA a policy and practice of unlawful, gender-based discrimination with respect to salary, emanating from a central administration and injuring all members of the class . . . .

. . . .

21. In years prior to 1981, TVA undertook wage and salary surveys among various selected private employers in the geographical area known as the vicinity . . . in arriving at wages for [TVA] employees . . . . When such surveys were completed, . . . [the survey results were used in bargaining] for wages and salaries.

22. Beginning sometime in late 1979 or early 1980, and continuing into 1981, defendants began to undertake a plan, program, and campaign to limit, restrict, confine and check wage and salary increases, focusing such plan, and campaign upon employees in the SB schedule, which made up the majority of employees affected by this program[, . . . by changing] the definition of vicinity that had been used in all prior years [for wage surveys]. . . .

23. Defendants knew, or should have known, in 1980 and at all times thereafter, that adoption of [certain aspects of this plan] would result in a lowering of wage schedules for the SB schedule.

. . .

24. . . . TVA unilaterally selected employers to be surveyed . . . for the SB schedule and the SF and SG schedules, and did make . . . salary surveys. The selection of these particular employers was designed and calculated to result in a reduced salary schedule for the SB schedule, and did result in such a reduced salary schedule for employees in the SB schedule.

25. In 1981, TVA continued its past practices of using a regional area survey for the SA, SD, and SE schedules, and its unilateral selection of employers produced increases in the salaries of employees in the SA, SD, and SE schedules, made up predominantly of male employees.

26. Utilizing the threat of terminating the [collective bargaining agreement between TVA and all employees], terms and conditions resulting in decreases in schedule pay for the vast majority of employees on the SB Schedule were imposed . . . by TVA in 1981. . . . Those employees on the SB, SF, and SG schedules . . . did not receive the increase in schedule pay similar to those that were awarded to the SA, SD, and SE schedules . . . .

27. Defendants knew, or should have known, that their unilateral changes [in regard to pay schedules] would result in increases for male-dominated schedules . . . and that these acts would result in decreases for female-dominated schedules . . . .

28. Defendants' acts and conduct . . . [were] intended to and did result in disparate treatment of its female employees in their rates of pay in violation of Title VII of the Act.

29. In the alternative, and in addition to disparate treatment of women, defendants' [changes to] pay schedules had a disparate impact on women, in further violation of Title VIII of the Act.

(Court File No. 8, exhibit 1: copy of Second Class Action Complaint). The plaintiffs sought the following relief:

> plaintiffs pray for judgment against defendants and for an order of this Court restraining and enjoining defendants from further discriminating against women in the SB schedule in wages and salaries and for a further order awarding back pay to all affected female employees in the SB schedule in an amount found to be just and proper sufficient to eliminate discrimination, for costs, for attorney's fees, and for such other relief as may be warranted in the premises.

In ruling upon a motion for summary judgment filed by the defendants in *Hutcheson*, the Court said that the plaintiffs had "made a *prima facie* case of disparate impact by showing that TVA adopted a facially neutral course of conduct (by changing the method it used to fix salary schedules for certain employee groups) which had a significantly adverse impact on female employees" (Court File No. 8, exhibit 4 at 3). This showing was deemed sufficient to shift the burden to the defendants to articulate a legitimate, nondiscriminatory reason for TVA's actions (*see* Court File No. 8, exhibit 5 at 2). The

Court further noted that "the plaintiffs have produced significant evidence from which discriminatory intent might be inferred by the trier of fact" (Court File No. 8, exhibit 4 at 3).

On March 13, 1987, "wish[ing] to finally settle and resolve the complaint" (Court File No. 8, exhibit 6 at 2), the parties in *Hutcheson* signed a Settlement Agreement ("Agreement"). The terms of the Agreement were as follows:

> 1. Nothing in this agreement is, or shall be construed as, an admission by defendants that TVA . . . has discriminated on the basis of sex against Hutcheson or any present or former TVA employee in the [group] represented by OPEIU. . . .
>
> . . . .
>
> 3. TVA shall pay the sum of $4,200 to [plaintiff] Hutcheson. . . .
>
> . . . .
>
> 5. . . . TVA will pay at OPEIU's direction a sum not to exceed $5,000,000, less any taxes which TVA may be required to pay because it is the employer of any person whom OPEIU may designate to receive a portion of said sum. OPEIU has determined that such amount will be paid to current employees of TVA represented by OPEIU (. . .), who have performed work on the SB schedule between June 28, 1981, and March 10, 1987. The amounts will be based upon pay rates and length of service in the SB schedule during the above period. . . . TVA will have no liability or responsibility to OPEIU with respect to TVA's actions hereunder, and OPEIU will defend, indemnify, and hold harmless TVA . . .

against any liability for any claims, demands, actions, causes of action, payments, backpay, damages, fees, costs, or judgments, on behalf of any person (. . .), arising out of or related in any way to this paragraph of this agreement.

This agreement is made for the purpose of resolving litigation and for no other purpose. . . . Any payments made pursuant to paragraph 5 of this agreement . . . are deemed and considered by OPEIU as litigation benefits provided for those TVA employees on the date of execution of this agreement who are represented by OPEIU on such date and for no other purpose.

. . . .

9. This agreement is the full and final settlement of the pending complaint, as amended. . . . In consideration of the foregoing payments and agreements, Hutcheson and OPEIU hereby release, acquit, and forever discharge TVA, its Board of Directors, agents, officers, and employees from any and all actions, causes of action, claims, demands, damages, costs, expenses, compensation, costs, attorney fees, and liability on account of or in any way related to or arising out of any matters alleged in the administrative class complaint or in the judicial complaint, as amended. . . .

On May 6, 1987, the Agreement was amended as follows:

> 5. . . . TVA will pay at OPEIU's direction a sum not to exceed $5,000,000, less any taxes which TVA may be required to pay because it is the employer of any person whom OPEIU may designate to receive a portion of said sum. OPEIU has determined that such amount will be paid to all persons who were employed on the SB schedule at any time between June 28, 1981, through and including March 10, 1987. . . .

(Court File No. 8, exhibit 7). George E. Barrett, who was a principal attorney representing the plaintiffs in *Hutcheson*, states that "[a]t no time during [settlement] discussions was there any reference by any of the participating attorneys that any payment to and through OPEIU would be considered as back pay" (Court File No. 8 at para. 14). TVA determined, however, that it "would not distribute any money to any individuals unless income tax withholding and FICA moneys were deducted" (*id.* at para. 16).

The various payments were made to the various plaintiffs in *Hutcheson* and the various deductions were made from those payments. Specifically, it has been stipulated (Court File No. 15 at paras 9-12) that plaintiff Therese A. Burke was entitled to $764.94 of the settlement proceeds; plaintiff Cynthia R. Carter was entitled to $927.55; and plaintiff Linda G. Gibbs was entitled to $572.95. The TVA withheld $152.99 federal income tax and $54.69 FICA tax from the payment to plaintiff Burke, $185.51 federal income tax and $66.32 FICA tax from the payment to plaintiff Center, and $114.39 federal income tax and $40.97 FICA tax from the payment to plaintiff Gibbs. The plaintiffs then filed this law suit to recover the amounts withheld as taxes.

Discussion

Section 61(a) of the Internal Revenue Code [2] provides that gross income includes "all income from whatever source derived," unless otherwise provided. 26 U.S.C. § 61(a) (1988). Section 104(a)(2) provides (otherwise) that gross income does not include "the amount of any damages received (whether by suit or agreement and whether as lump sum or as periodic payments) an account of personal injuries or sickness . . . ." 26 U.S.C. § 104(a)(2) (1988). The pertinent tax regulations provide that "[t]he term 'damages received (whether by suit or agreement)' means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution." 26 C.F.R. § 1.104-1(c).

As pertinent to the instant case, "the essential element of an exclusion under section 104(a)(2) is that the income involved must derive from some sort of tort claim against the payor." *Glynn v. Commissioner*, 76 T.C. 116, 119 (1981), *aff'd*, 676 F.2d 682 (1st Cir. 1982); *see also Byrne v. Commissioner*, 90 T.C. 1000 (1988); *Bent v. Commissioner*, 87 T.C. 236, 244 (1986), *aff'd*, 835 F.2d 67 (3d Cir. 1988). Thus, the Court "must look to the nature of the underlying injury to determine excludability under section 104(a)(2)." *Threlkeld v. Commissioner*, 848 F.2d

[2] Since all events transpired prior to the recent amendments to the Internal Revenue Code, all references are to the Internal Revenue Code of 1954, as amended and in effect for the year in issue: 1987.

81, 84 (6th Cir. 1988). In addition, the law is clear that the tax consequences of an award for damages depend upon the nature of the litigation and on the origin and character of the claims adjudicated, and not on the validity of those claims. *Bent v. Commissioner*, 87 T.C. 236 (1986); *Glynn v. Commissioner*, 76 T.C. 116, 119 (1981), *aff'd*, 676 F.2d 682 (1st Cir. 1982) (table); *Seay v. Commissioner*, 58 T.C. 32, 36-37 (1972).

In this case, the plaintiffs were beneficiaries of a prior suit (*Hutcheson*) brought against the TVA for violations of Title VII of the Civil Rights Act of 1964. Such a damage action "sounds basically in tort—the statute merely defines a new legal duty, and authorizes the courts to compensate a plaintiff for the injury caused by the defendant's wrongful breach." *Curtis v. Loether*, 415 U.S. 189, 195 (1974) (dealing with the Fair Housing Act, 42 U.S.C. § 3601, *et seq.*). Title VII provides, in pertinent part, that:

> [i]t shall be an unlawful employment practice for an employer—
>
> (1) to refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his [sic] compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin; or
>
> (2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his [sic] status

> as an employee, because of such individual's race, color, religion, sex, or national origin.

42 U.S.C. § 2000e-2(a). The injuries for which relief is sought under Title VII are "personal injuries." *Metzger v. Commissioner*, 88 T.C. 834 (1987), *aff'd*, 845 F.2d 1013 (3d Cir. 1988) (table). "[S]ex discrimination actions in general are tort or tort-type actions and damages awarded for violation of that right are damages for personal injuries." *Thompson v. Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989); *see also Davis v. Passman*, 442 U.S. 228, 235 n.10 (1979); *Cannon v. Univ. of Chicago*, 441 U.S. 677, 690-93, n.13 (1979); *compare Monongahela Navigation Co. v. United States*, 148 U.S. 312-26 (1893).[3]

Title VII provides for the following remedies:

> [i]f the court finds that the respondent has intentionally engaged in or is intentionally engaging in an unlawful employment practice charged in the complaint, the court may *enjoin* the respondent from engaging in such unlawful employment practice, and order such affirmative action as may be appropriate, which may include, but is not limited to, *reinstatement or hiring* of employees, *with or without back pay . . . or any other equitable relief* as the court deems appropriate. . . . Interim earnings or amounts earnable with

[3] *See also Threlkeld v. Commissioner*, 87 T.C. 1294, 1301 (1986) ("Exclusion under section 104 will be appropriate if compensatory damages are received on account of any invasion of the rights that an individual is granted by virtue of being a person in the sight of the law."); *Black's Law Dictionary* 1335 (5th ed. 1979) (a tort action is one for "a direct invasion of some legal right of the individual," independent of a contract).

> reasonable diligence by the person or persons discriminated against shall operate to reduce the back pay otherwise allowable.

42 U.S.C. § 2000e-5(g) (emphasis added). It is well established in this Circuit that prevailing plaintiffs in Title VII actions are entitled to equitable relief (which may, in the Court's discretion, entail front pay,[4] *see Gutzwiller v. Fenik*, 860 F.2d 1317, 1333-34 (6th Cir. 1988); *Shore v. Federal Express Corp.*, 777 F.2d 1155, 1158-60 (6th Cir. 1985)), coupled with back pay and fringe benefits,[5] but are not entitled to compensatory or punitive damages.[6] *Mitchell v. Sea-*

[4] "[F]ront pay is an award of future earnings to make a victim of discrimination whole." *Cassino v. Reichhold Chemicals, Inc.*, 817 F.2d 1338, 1346 (9th Cir. 1987), *cert. denied*, 469 U.S. 1181 (1985). More precisely, it is "designed to compensate the plaintiff for economic losses that have not occurred as of the date of the court decree, but that may occur as the plaintiff works toward his or her rightful place." Note, *Front Pay—Prophylactic Relief under Title VII of the Civil Rights Act of 1964*, 29 Vand. L. Rev. 211, 212 (1976).

[5] "Fringe benefits include sick and vacation pay and mileage expenses which an employer would have paid the employee in the normal course of business." *Mitchell v. Seaboard System R.R.*, 883 F.2d 451, 453 (6th Cir. 1989) (citing *Rasimas v. Michigan Dept. of Mental Health*, 714 F.2d 614, 626 (6th Cir. 1983), *cert. denied*, 466 U.S. 950 (1984)).

[6] "[C]ompensatory damages are those which repay an individual for out-of-pocket losses and less tangible losses, such as harm to reputation and personal humiliation." *Mitchell*, 883 F.2d at 453 (citing *Memphis Comm. Sch. Dist. v. Stachura*, 477 U.S. 299, 307 (1986)). Punitive damages are those

> awarded to the plaintiff over and above what will barely compensate him [sic] for his . . . loss, where the wrong done to him was aggravated by circumstances or violence, oppression, malice, fraud, or wanton and wicked

board System R.R., 883 F.2d 451, 452-53 (6th Cir. 1989); *Body v. Dean*, 821 F.2d 346, 352 (6th Cir. 1987); *accord Bennett v. Carroon & Black Corp.*, 845 F.2d 104, 106 (5th Cir. 1988), *cert. denied*, —— U.S. ——, 103 L.Ed.2d 201 (1989); *Protos v. Volkswagen of America, Inc.*, 797 F.2d 129, 137-38 (3d Cir.), *cert. denied*, 479 U.S. 972 (1986); *Patzer v. Bd. of Regents of Univ. of Wisconsin System*, 763 F.2d 851, 854 n.2 (7th Cir. 1985); *Walker v. Ford Motor Co.*, 684 f.2d 1355, 1363-64 (11th Cir. 1982) (and cases cited); *Shah v. Mt. Zion Hosp. and Medical Center*, 642 F.2d 268, 272 (9th Cir. 1981); *see generally* B. Schlei & P. Grossman, *Employment Discrimination Law*, 1434-36 (2d ed. 1976); D. Cathcart & R. Ashe, eds., *Five-Year Cumulative Supplement to Schlei & Grossman's Employment Discrimination Law, 2d ed.*, 533-35 (1989). Thus, as a general proposition, "[e]mployers who discriminate in the payment of wages are liable under . . . Title VII for back pay in the amount of the differential between the wages received and the wages which would have been paid absent the discrimination." *Thompson v. Commissioner*, 866 F.2d 709, 711 (4th Cir. 1989) (citing 29 U.S.C. § 216(b); 42 U.S.C. § 2000e-5(g)). Payments received of unpaid salary or wages nevertheless are not excludable under section 104(a)(2). *Hodge v. Commissioner*, 64 T.C. 616, 619 (1975); *see also Johnson v. Georgia Highway Express, Inc.*, 417 F.2d 1122, 1125 (5th Cir. 1969); *Rickel v. Commissioner*, 92 T.C. 510 (1989); *Thompson*, 89 T.C. at 646-47.

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conduct on the part of the defendant, and are intended . . . [in part] to punish the defendant for his evil behavior or to make an example of him . . . .

Blacks Law Dictionary 352 (5th ed. 1979).

In the case of settlement of a tort case, however, the court "is not necessarily barred from entering a consent decree merely because the decree provides broader relief than the court could have awarded after a trial." *Local 93, Int'l Ass'n of Fire Fighters v. City of Cleveland*, 478 U.S. 501, 525 (1986). Thus, damages received as a result of settlement of a Title VII suit may be excludable under section 104(a)(2), *Metzger*, 88 T.C. at 858, to the extent that the parties agreed to a settlement which did not entail payment of back pay.

In such a case, excludability depends "on what was the injury complained of, and the loss of income may merely be 'an evidentiary factor' or 'the best measure of loss'." *Metzger*, 88 T.C. at 858 (citations omitted). As the Tax Court noted in *Thompson v. Commissioner*, 89 T.C. 632 (1987):

> Since . . . a sex discrimination suit may be a suit for a personal injury, it is necessary to decide whether the amount of liquidated damages received by petitioner was received as compensation for this personal injury or was received as part of the back pay award.
>
> The fact that by statute this award is measured by the amount of back pay due to petitioner in our view is not controlling. . . . Liquidated damages are awarded where the employer cannot show that the sex discrimination was in good faith. In our view, sex discrimination which was not in good faith is a personal injury and the liquidated damages, even though measured by the back pay due, are nevertheless paid as damages for a personal injury. . . . [L]iquidated damages [are] compensatory rather than penal in nature and [are] intended to compensate for intangible

> losses difficult to measure, but nevertheless the consequences of unfair wages. . . . Other than being measured by the amount of back pay, . . . liquidated damages are not directly related to back pay.

Another way of making a determination whether the payments were for unpaid salary or wages is to ask, "in lieu of what were the damages awarded?" *Church v. Commissioner*, 80 T.C. 1104, 1107 (1983); *Fono v. Commissioner*, 79 T.C. 680 (1982), *aff'd*, 749 F.2d 37 (9th Cir. 1984) (table); *Yates v. Commissioner*, 58 T.C. 961, 972 (1972), *aff'd*, 480 F.2d 920 (1973) (table); *see also Raytheon Production Corp. v. Commissioner*, 144 F.2d 110-113 (1st Cir. 1944). When the settlement agreement does not expressly state that settlement payment is made for personal injury, then the most important factor in determining whether section 104(a)(2) exempts the payment is "the intent of the payor" in making the payment. *Knuckles v. Commissioner*, 349 F.2d 610, 613 (10th Cir. 1965); *Byrne*, 90 T.C. at 1007; *Metzger*, 88 T.C. at 847-48; *Fono v. Commissioner*, 79 T.C. 680, 694 (1982), *aff'd*, 749 F.2d 37 (9th Cir. 1984) (table); *Glynn v. Commissioner*, 76 T.C. at 120.

In this case, *Hutcheson* was settled and it is represented that "[a]t no time during [settlement] discussions was there any reference by any of the participating attorneys that any payment to and through OPEIU would be considered as back pay" (Court File No. 8 (affidavit of George E. Barrett) at para. 14). It is not dispositive, however, that the phrase "back pay" was not mentioned during settlement negotiations, since the *Hutcheson* complaint makes it clear that the very core of the case was recovery of wage deficiencies. In fact, the entire complaint refers *only* to wage discrimination (*see* Court File No. 8, exhibit 1 at paras. 18 (alleging "a policy and practice of unlawful, gender-based discrimination with respect to salary"); 23 (alleging that "[d]efendants knew, or should have known . . . [that their actions] would result in a lowering of wage schedules for the SB schedule"); 28 (alleging "[d]efendants' acts and conduct . . . [were] intended to and did result in disparate treatment of its female employees in their rates of pay"); 29 (alleging that "disparate treatment of women . . . had a disparate impact on women")).

More importantly, the Settlement Agreement states that individual allocation of monies received from the TVA in settlement of the suit "will be based upon pay rates and length of service in the SB schedule" (Court File No. 8, exhibits 6 & 7 at para. 5). When coupled with the fact that the complaint refers only to wage discrimination, it is more apparent that the payments dispersed by TVA to the various plaintiffs in *Hutcheson* were not merely "measured by" back wages allegedly due to the plaintiffs in *Hutcheson*, *see Thompson*, 89 T.C. at 646-48; *Metzger*, 88 T.C. at 858, but were payments "in lieu of" wages not paid under schedules derived from the allegedly sexually biased regional studies, *see Church*, 80 T.C. at 1107. *See Hodge v. Commissioner*, 64 T.C. 616, 620 (1975); *Sparrow v. Commissioner*, T.C. Memo 1989-315 (1989).

Finally, the plaintiffs in *Hutcheson* accepted language in the Settlement Agreement that "TVA will pay . . . a sum not to exceed $5,000,000, less any taxes which TVA may be required to pay because it is the employer of any person whom OPEIU may designate to receive a portion of said sum" (Court File

No. 8, exhibits 6 & 7 at para. 5). Thus, the plaintiffs in *Hutcheson* tacitly accepted that the sums to be received under the Settlement Agreement were in the nature of back pay. Given all these facts, "there is nothing . . . that converts a claim for back pay, because an individual has been underpaid for the work he [sic] has done, into a claim for damages for a personal injury merely because the suit which involves such a claim may also have a tort-type action for personal injuries." *Thompson*, 89 T.C. 632.

In conclusion, the facts indicate that the settlement in *Hutcheson* entailed TVA's payment of partial back pay to the plaintiffs, in direct satisfaction of their claims and allegations in their complaint. *See Hodge*, 64 T.C. at 619. Since the disbursements to the *Hutcheson* plaintiffs under their Settlement Agreement were back pay, they were not excludable from gross income under section 104(b)(2). For this reason, the plaintiff's motion for summary judgment (Court File No. 6) will be DENIED. Since the issues are clear and since the case has been submitted for decision on the record, the Court, *sua sponte*, will GRANT summary judgment to the defendant and this case will be DISMISSED.

An order will enter.

/s/ R. Allan Edgar
R. ALLAN EDGAR
United States District Judge

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 90-5607

THERESE A. BURKE; CYNTHIA R. CENTER;
LINDA G. GIBBS, PLAINTIFFS-APPELLANTS

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

On Appeal from the United States District Court
for the Eastern District of Tennessee at Chattanooga

Before: Merritt, Chief Judge; Jones, Circuit Judge;
Wellford,* Senior Circuit Judge

JUDGMENT

[Filed Apr. 5, 1991]

THIS CAUSE was heard on the record from the district court and was argued by counsel.

ON CONSIDERATION WHEREOF, it is ordered that the judgment of the district court is reversed

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* The Honorable Harry W. Wellford assumed senior status on January 21, 1991.

and remanded for entry of an order consistent with the opinion.

ENTERED BY ORDER OF
THE COURT

/s/ Leonard Green, Jr.
LEONARD GREEN
Clerk

A True Copy.

Attest:

/s/ [Illegible]
Deputy Clerk

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Supreme Court, U.S.
FILED
JUL 29 1991
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No. 91-42

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

UNITED STATES OF AMERICA,
Petitioner,

v.

THERESE A. BURKE, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether discrimination on the basis of sex is a tort-like personal injury, such that amounts received in settlement of a claim for sex discrimination in violation of Title VII of the Civil Rights Act of 1964, and designated in the settlement agreement as "litigation benefits" and not as back wages, are "damages received . . . on account of personal injuries" and therefore excludable from gross income under Section 104(a)(2) of the Internal Revenue Code.

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF FOR RESPONDENTS IN OPPOSITION

PRELIMINARY STATEMENT

This brief is submitted in opposition to the pending Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit. Respondents Therese A. Burke, Cynthia R. Center, and Linda G. Gibbs, are employees of the Tennessee Valley Authority and members of the Office and Professional Employees International Union, AFL-CIO (OPEIU). As such, they were among the beneficiaries of a lump sum payment from TVA in settlement of a Title VII sex discrimination case pursued by Judy Hutcheson and the OPEIU. This underlying case alleged that TVA had discriminated against female employees when, in 1981, it altered the means used to determine salaries for jobs in a salary schedule

dominated by women (Schedule SB), with the intent that the change would result in raising the salaries of other male-dominated salary schedules while reducing or holding stagnant the salaries of the female dominated SB jobs.

The Petition seeks review of a decision determining the income tax consequences of the amounts individuals received as litigation benefits in settlement of the sex discrimination claim. The Court of Appeals found that "injuries sustained in violation of Title VII are 'personal injuries,' and that damages resulting from such injuries are excludable from taxation under § 104(a)(2)" of the Internal Revenue Code. *Burke v. United States*, 929 F.2d 1119, 1119-20 (6th Cir. 1991) (Pet. App. 2a).[1] Relying on prior decisions of this Court, as well as numerous lower courts, the Sixth Circuit concluded that "injuries resulting from invidious discrimination . . . are injuries to the individual rights and dignity of the person." *Id.* at 1121 (Pet. App. 6a). Thus, damages received in settlement of claims for such injuries are "damages received . . . on account of personal injuries" and thus excludable from income under Section 104(a)(2). Relevant to the United States' claim that the damages should be taxed because they were for back wages, the Court of Appeals noted the significant facts of the underlying Title VII case, namely that the settlement agreement did not so designate the lump sum payment, and that TVA had not withheld taxes from the individual lump sum compensation paid to Judy Hutcheson, the only named individual plaintiff. The Sixth Circuit also rejected the United States' attempt to turn this into a case about back pay by holding that under the language of Section 104(a)(2), its interpreting regulations, Tax Court rulings, and numerous decisions of the Courts of Appeals, the relevant inquiry for determining excludability was

[1] References to Pet. App. are to the Appendix attached to the Petition for A Writ of Certiorari submitted by the United States.

the personal nature of the injury, and not the consequences (pecuniary loss or nonpecuniary loss) that flowed from the legal violation. *Id.* at 1121 (Pet. App. 6a).

With this Petition, the United States again seeks to inject into this case the argument, factually erroneous and legally irrelevant, that the lump sum settlement proceeds in the Title VII case were no more than deferred compensation, or back wages. Thus, the Petition mischaracterizes the factual posture and question decided below, and thus the Question presented to this Court. Accordingly, we have re-stated the Question Presented at the outset of this brief.

By misconstruing the damages in this case as tantamount to a contract claim for wages owed for work performed, the Petition attempts to manufacture a conflict in the Circuits that does not, in fact, exist, as is evident when the facts and actual holdings of the supposedly conflicting decisions are properly understood. Thus, there is no reason to grant the Writ. Moreover, the Writ should not issue because the decision below was clearly correct in following prior decisions of this Court characterizing the injury of invidious discrimination as personal in nature.

COUNTER-STATEMENT OF THE CASE

While the Statement of the Case offered by Petitioner United States is accurate insofar as it goes, it does not provide sufficient detail about the terms of the settlement of the underlying Title VII action for this Court to appreciate the particular reasons this case does not involve the issue of payment for deferred wages.

The underlying settlement came about after the district court denied cross-motions for summary judgment and ruled that plaintiffs Hutcheson and OPEIU had made out a prima facie case that TVA had committed

illegal sex discrimination. The settlement agreement provided for a lump sum payment of $4200 to individual plaintiff Judy Hutcheson. Although TVA was Hutcheson's employer, it did not withhold income taxes or FICA from her damages.

The remainder of the settlement was also in a lump sum amount, of $5,000,000, to be distributed to eligible individuals according to a formula to be determined by the OPEIU. This lump sum payment was designated as "litigation benefits" paid "for the purpose of resolving litigation" according to the specific terms of paragraph 5 of the settlement agreement. The Union determined that both length of service and rate of pay should be taken into account to determine the amount to be distributed to each individual. In most personal injury cases, including discrimination actions, rate of pay is a readily available reference point for measuring damages. The amount designated for each individual under the distribution formula did not simply equal any differential between the discriminatory rates of pay and a nondiscriminatory rate of pay. Indeed, the damages could not possibly have reflected a simple pay differential, because the calculation of what a nondiscriminatory wage structure might have been for female dominated job categories for the past years in question would have been a formidable, near impossible task.

Because the OPEIU did not have the administrative capability to distribute the lump sum settlement to the large number of entitled individuals, the Union asked TVA to perform the distribution according to the amounts determined by the OPEIU formula. TVA, concerned that as the employer of those to whom it would be distributing money it might be assessed liability if it did not withhold taxes, pursuant to IRC §§ 3101, 3102 (a), and 3402(a), insisted that it would perform the distribution only if it could withhold taxes. Fearful that the entire settlement would fall apart, the Union had

little choice but to accede to this demand. Consequently, the initial settlement agreement was amended to state that TVA would perform the distribution and that it would make the payments "less any taxes which TVA may be required to pay because it is the employer of any person whom OPEIU may designate to receive a portion of said sum." The Union's acquiescence to tax withholding in no way converted the lump sum settlement amount designated as "litigation benefits" into deferred wages.

The settlement agreement also provided that any amount which TVA was unable to distribute would be paid to the Union, "with a listing of the individuals involved and the amounts payable to each." As with the damages paid to Hutcheson, TVA did not make any tax withholdings from the portion of the $5,000,000 that it paid to the OPEIU (a total of $114,380.51, or 2.3% of the whole). OPEIU later did make distribution to some six individuals who came forward, tendering them the full amount to which they were entitled, without any reduction for taxes.

While recoveries in some employment discrimination cases, such as Equal Pay Act claims, might conceivably be only for the purpose of replacing a readily determinable exact amount of wages wrongfully deprived, the factual history recounted above demonstrates that the damages paid in this case cannot be so construed. The damages paid fulfilled the same purpose for all recipients, all of whom had experienced the same personal injury. They were, as stipulated by the settlement agreement, litigation benefits paid to resolve litigation for having suffered the indignity of discrimination, and for having brought TVA to account for its wrongful sex-based discrimination.

REASONS FOR DENYING THE WRIT

Petitioner United States misconstrues the nature of the injury and the settlement payments in the underlying Title VII case, and thus misstates the Question presented as involving the taxability of back wages. The Question as stated in the Petition, which departs from the particular facts of the case, leads to the appearance of a conflict among the Circuits. But, when the unique factual posture of this case, and the consequent nature of the settlement proceeds, are properly assessed and compared to the issues decided by the allegedly conflicting decisions, it is apparent that there is not the sort of conflict that might warrant review by this Court. Indeed, the circuit courts are remarkably uniform in concluding that invidious discrimination is a tort-like personal injury, no matter which of several available statutes are invoked to remedy it.

I. THERE IS NO CONFLICT BETWEEN THE CIRCUITS

The case the Petitioner principally advances as posing a conflict is the Fourth Circuit's decision in *Thompson v. Commissioner*, 866 F.2d 709 (4th Cir. 1989). The assertion that *Thompson* is in conflict with the decision below is curious, since the Fourth Circuit ruled consistently with the Sixth Circuit on all relevant legal issues. Both decisions are in agreement that under Section 104(a)(2) of the Code and the implementing Treasury regulations, 26 C.F.R. § 1.104-1(c), the relevant inquiry for determining excludability is whether an award is received for personal injuries through prosecution of a legal action based upon tort or tort-type rights. *Compare* 866 F.2d at 711 *with* 929 F.2d at 1121 (Pet. App. at 5a-6a). The Fourth Circuit also decided, consistent with the Sixth Circuit, that because "the right to be free from unreasonable gender discrimination is a personal right" (citing *Davis v. Passman*, 442 U.S. 228, 235 n.10, 99 S.Ct. 2264, 2271 n.10, 60 L.Ed.2d 846 (1979)), "sex discrimination

actions in general are tort or tort-type actions and damages awarded for violation of that right are damages for personal injuries." 866 F.2d at 712. The Sixth Circuit cited this ruling in reaching the identical conclusion. 929 F.2d at 1121 (Pet. App. 6a). The identical conclusions of the Fourth and Sixth Circuits regarding the personal, tort-like nature of the injury in Title VII sex discrimination cases determines the excludability issue under Section 104(a)(2).

A fair reading of *Thompson* reveals that it was essentially a treatment of tax consequences of an Equal Pay Act judgment without any probing consideration of the consequences of a Title VII violation. It was only coincidental on the facts of that case that the contract wage disparity also happened to be a violation of Title VII.

The Fourth Circuit concluded that back-pay awards under the Equal Pay Act are "more in the nature of a payment for a contract violation than for a tort-type right," and thus were not excludable under Section 104(a)(2). The court relied for its conclusion on the text of the Equal Pay Act itself, which characterized the back pay recoverable under that statute as "unpaid minimum wages or unpaid overtime compensation." 29 U.S.C. § 206(d)(3). Thus, the Court said, back pay awards under the Equal Pay Act should be distinguished "from awards for lost wages or lost income in traditional personal injury/tort actions" (such as general sex discrimination claims). 866 F.2d at 712. See also *Kurowski v. C.I.R.*, 917 F.2d 1033, 1037 (7th Cir. 1990); *Sparrow v. Commissioner*, 57 T.C.M. (CCH) 816, 820 (1989), appeal pending, No. 90-1151 (D.C. Cir.) (interpreting *Thompson* holding on taxability of damages as based on Equal Pay Act, rather than Title VII).

Because the Fourth Circuit dealt exclusively with the tax consequences of an Equal Pay Act violation, it is evident that its ruling in *Thompson* poses no conflict with the Sixth Circuit's ruling on the nature of claims under Title VII, or their tax consequences.

The reasoning of *Thompson*, tied as it was to the Equal Pay Act, cannot be applied to Title VII. Unlike the Equal Pay Act, Title VII contains no statutory language characterizing recoveries for violations as "unpaid minimum wages or unpaid overtime compensation." The statutory characterization of the Equal Pay Act is understandable, given the nature of claims under the Act. The Act applies only to sex-based wage differentials for what is essentially the *same job*. Thus, there is a readily available contractual measure for recovery, namely, the higher wage rate paid to the men doing the same work. A recovery under the Act can be considered deferred wages for work actually performed because the recipient in fact performed the same work as male employees but did not receive the same rate of pay for the job.

In contrast, in a Title VII wage discrimination case, such as the underlying case in the present matter, the damages cannot be so characterized as contractual wages for work actually performed. The claim here is not, as in the *Thompson* Equal Pay Act claim, that the women workers did the identical work as males, and should therefore get the wage rate for the job performed by both. Rather, in the present situation, the jobs in the female-dominated SB salary schedule were not the same as the jobs in male-dominated schedules. The SB workers all received the full contractual measure of wages for their jobs. In other words, they were paid all they were contractually entitled for the work performed. But, as they successfully contended in the underlying Title VII suit, the manner and method of adoption of the contract rate for their jobs was impermissibly influenced by sex-based discrimination. Hence, they were victimized by the invidious discrimination, and required compensation "to make them whole from a previous loss of personal rights." *C.I.R. v. Miller*, 914 F.2d 586, 590 (4th Cir. 1990).

Moreover, given the particulars of the settlement agreement involved in the present case, the *Thompson* Equal

Pay rationale that the wages were contractually owed is obviously inapposite. There was no attempt, either in determining the lump sum settlement amounts or in fashioning the individual amounts to be distributed, to calculate a wage differential between similarly situated male and female employees. *Cf. Thompson*, 866 F.2d at 712. There was no effort made to peg the amount of individual distributions to any assessment of wages lost due to the discrimination. And, neither party to the settlement characterized the amounts as wages or in lieu of wages. Rather, the payments were designated by TVA as "for the purpose of resolving litigation" and by OPEIU as "litigation benefits." (Settlement Agreement para. 5; Amendment to Settlement Agreement para. 1, p.3).

The inapplicability of the *Thompson* Equal Pay Act ruling to the present Title VII situation is further underscored by the fact that the Equal Pay Act, unlike Title VII, is not classified as a civil rights statute. The Pay Act is contained in Title 29 of the U.S. Code, the Title pertaining to labor and commerce regulation, and was not enacted as part of a comprehensive Civil Rights Act. This placement suggests that it was intended to protect economic rights, rather than personal dignitary rights to be free from invidious discrimination. Title VII, on the other hand, was enacted as part of the Civil Rights Act of 1964, and is codified among the panoply of other civil rights protections in Title 42 of the U.S. Code. This placement underscores the conclusion that the rights protected by Title VII are personal, and the injuries suffered when such rights are violated are, in fact, personal injuries. *Cf. Goodman v. Lukens Steel Co.*, 482 U.S. 656, 661 (1986) (fact that 42 U.S.C. § 1981 appears in the Chapter titled Civil Rights supports the determination that injuries made actionable by this statute are personal injuries, even though the statute pertains to the making of contracts; right to be free from discrimination in making of contracts is a personal right).

For these reasons, the portion of *Thompson* that interprets the Equal Pay Act is neither applicable to, nor in conflict with, the Sixth Circuit determination that the nature of harm redressed by Title VII is personal injuries from invidious discrimination.

Petitioner United States also suggests, without analysis, that the decision of the U.S. Court of Appeals for the Fifth Circuit in *Johnston v. Harris County Flood Control District*, 869 F.2d 1565 (5th Cir. 1989), *cert. denied*, 110 S. Ct. 718 (1990), conflicts with the decision of the Sixth Circuit. Given the legally significant factual differences regarding the determination of damages in *Johnston* compared with the present case, *Johnston* is readily distinguishable.

Johnston concerned the method by which a trial court should determine the amount of back wages owed in an employment discrimination case brought under 42 U.S.C. § 1983 and Title VII. Such a ruling has little relevance to the present case, in which there never was any determination of an amount of back wages owed, either by the trial judge or the settling parties. The present case concerns only the characterization of a lump sum settlement amount in a case brought to redess the personal injury of invidious discrimination, when such settlement amount was designated by the parties not as attributable to wages but as "litigation benefits" paid "for the purpose of resolving litigation." The *Johnston* decision neither analyzed nor ruled on the determinative legal issue in the Sixth Circuit's opinion below: whether the nature of the injury of discrimination made actionable by Title VII is personal and tort-like in nature. For these reasons, the decision of the Fifth Circuit Court of Appeals does not present a square conflict with the Sixth Circuit.[2]

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[2] In a footnote in the Petition for a Writ of Certiorari, the United States also suggests that the decision in *Sears v. A.T. & S.F. Ry.*, 749 F.2d 1451 (10th Cir. 1984), cert. denied, 471 U.S. 1099 (1985), stands contrary to the decision below. Similar to *Johnston*, the *Sears* decision concerned whether the trial court had abused its discretion in including a tax component in calculating the back pay award in a Title VII case. The analysis of the Court of Appeals turned on the Tax Code provisions for income averaging, a feature that is no longer part of the Code. In addition, the Tenth Circuit noted that "a tax component may not be appropriate in a typical Title VII case." 749 F.2d at 1456. And again, as in *Johnston*, the court did not discuss the central issue in the Sixth Circuit decision below—the characterization of discrimination as a personal injury. When, more recently than *Sears*, the Tenth Circuit did analyze this issue, it concluded that the victim of wrongful employment practices who sued under 42 U.S.C. § 1983 had suffered a personal injury for which he brought a tort-type claim. Thus, the award of back pay, which compensated him "for the economic injury resulting from the denial of his constitutional rights" was "an award of damages 'on account of personal injuries' and therefore not taxable" under I.R.C. § 104(a)(2). *Wulf v. City of Wichita*, 883 F.2d 842, 873 (10th Cir. 1989). *Wulf* was among the Court of Appeals decisions that provided guidance to the Sixth Circuit in determining how to characterize the injuries of age, sex, or race discrimination in employment. Thus, the Tenth and Sixth Circuits are in harmony.

In fact, the Courts of Appeals that have addressed, for purposes of applying Section 104(a)(2), whether employment-related discrimination is a personal injury redressed by a tort-like claim, stand in unanimity that it is an invasion of a personal right. In addition to *Thompson* and the decision below, *see Pistillo v. C.I.R.*, 912 F.2d 155 (6th Cir. 1990); *Rickel v. Commissioner*, 900 F.2d 655 (3rd Cir. 1990); *Best v. Commissioner*, 835 F.2d 67 (3rd Cir. 1987); *Kurowski v. C.I.R.*, 917 F.2d 1033 (7th Cir. 1990); *Wulf v. City of Wichita*, 883 F.2d 842 (10th Cir. 1989). *See also Metzger v. Commissioner*, 88 T.C. 834 (1987), aff'd without opinion, 845 F.2d 1013 (3rd Cir. 1988).

Because there is no conflict between the circuits on the issue actually involved in this case, there is no basis for granting the writ.

II. THE DECISION OF THE SIXTH CIRCUIT IS COMPELLED BY CONTROLLING PRECEDENTS OF THIS COURT, AND THEREFORE PRESENTS NO ISSUE WARRANTING REVIEW

The central issue in this case is not the meaning and scope of § 104(a)(2), but, as the Sixth Circuit recognized, the meaning and characterization of the harm resulting from invidious discrimination in the employment context.

The meaning of the terms used in § 104(a)(2) of the Internal Revenue Code, and its implementing regulations, 26 C.F.R. § 1.104-1(c) (1990), are clear. The statute excludes from taxable income "the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness." The Treasury regulations define a claim for personal injuries under § 104(a)(2) as one based upon "tort or tort-type rights."

By their terms, these provisions make no distinctions between physical personal injuries and nonphysical personal injuries. Nor do they make any distinctions between the economic and noneconomic consequences that flow from personal injuries. or the portion of damages attributable to pecuniary loss or to other forms of loss. *See, e.g., Roemer v. Commissioner*, 716 F.2d 693 (9th Cir. 1983); *Threlkeld v. Commissioner*, 87 T.C. 1294 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988). Consequently, as numerous courts including the Sixth Circuit below have held, the proper basis for determining whether the §104(a)(2) exclusion applies "requires an examination of the nature of the injury to determine whether the injury and claim are personal and tort-like in nature, and not whether the consequences of the injury resulted in an award of compensatory damages or damages for back pay." *Burke*, 929 F.2d at 1121 (Pet. app. 6a); *Threlkeld, supra*, 87 T.C. at 1299, 848 F.2d at 84; *Pistillo v. Commissioner*, 912 F.2d 145, 148-49 (6th Cir. 1990); *Rickel v. C.I.R.*, 900 F.2d 655 (3rd Cir. 1990); *Byrne v. Commissioner*, 883 F.2d 211 (3rd Cir. 1989); *Metzger v. Commissioner*, 88 T.C. 834 (1987), aff'd without pub. op'n, 845 F.2d 1013 (3rd Cir. 1988); *Bent v. Commissioner*, 853 F.2d 67 (3rd Cir. 1987); *Wulf v. City of Wichita*, 883 F.2d 842, 872-73 (10th Cir. 1989); *Roemer v. Commissioner*, 716 F.2d 693 (9th Cir. 1983).

According to this widely agreed-upon test which is compelled by the language of the statute and regulations, the only issues to be determined in the present case are whether amounts recovered in a Title VII case serve as compensation for personal injury; and whether suffering discrimination in employment based on race, sex, religion, or national origin is an injury to personal rights, such that a claim that one's right to be free from such invidious discrimination has been violated is a claim based on "tort-type rights."

In the Petition, the United States never addresses these issues, nor does it offer any basis for concluding that the Sixth Circuit and all the other Courts of Appeals and the Tax Court have erroneously characterized employment discrimination actions as tort-like claims for personal injuries.

The dictionary definition of Tort makes it clear that a claim under Title VII is one based on "tort-type rights." Black's Law Dictionary (5th ed. 1979), defines a Tort as "a private or civil wrong or injury, other than breach of contract. . . . A violation of a duty imposed by general law or otherwise upon all persons occupying the relation to each other which is involved in a given transaction. . . . A legal wrong committed upon the person . . . independent of contract."

Invidious employment discrimination is a "civil wrong," and a violation of "a duty imposed" by Title VII. This duty has been imposed because society has made the moral and economic determination that in keeping with the commitment to equality of opportunity, as a

matter of law it will not abide such discrimination. Such duty exists wholly independent of contract. Thus, when one suffers employment discrimination in violation of Title VII it is a "personal injury" because one endures an "invasion of rights granted by virtue of being a person in the sight of the law." *Threlkeld v. Commissioner*, *supra*, 87 T.C. at 1308. *See, e.g., Johnson v. Railway Express Agency*, 421 U.S. 454, 457-58 (1975) (purpose of Title VII to create statutory rights against the wrong of invidious employment discrimination); *Rickel v. C.I.R.*, 900 F.2d at 662 (ADEA antidiscrimination provision is tort-like for these reasons); *Byrne v. Commissioner*, 883 F.2d at 215 (FLSA antidiscrimination provision creates tort-type rights under this analysis).

In the Petition, the United States acknowledges that this Court stated, in *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 418 (1975), that Title VII remedies are designed "to make persons whole for injuries suffered on account of unlawful employment discrimination." This statement is a classic formulation of the purpose of tort and tort-like remedies. Yet the United States seeks to evade the "personal injury/tort-type rights" issue by asserting that the recovery in a Title VII case is tied to income.[3] Yet this argument proves far too much, for a significant aspect of the recovery in most personal injury cases concerns lost income—both sums lost prior to judgment or sums prospectively lost. Tort law and tort-type

[3] The petitioner's argument that the damages in this case should be taxable turns on the argument that they were really no more than deferred wages. Ignoring the terms of the settlement agreement, petitioner turns for support to the fact that the complaint sought back pay, as any Title VII complaint must do, and that the case involved discrimination in setting wages. Because these arguments deal only with the *consequences* of the injury of discrimination, rather than the personal or non-personal *nature* of the injury, they are irrelevant. After all, wage loss figures prominently among the consequences of virtually all personal injuries, yet this hardly converts them into nonpersonal harms.

rights protect economic interests as well as physical and emotional interests. *See Prosser & Keeton on Torts* 2-3 (5th ed. West 1984); American Bar Ass'n, *Toward a Jurisprudence of Injury* 3-1 - 3-5 (1984). In recognition of this basic fact of tort law, the Internal Revenue Service itself has rejected the argument that the portions of personal injury recoveries attributable to wages are taxable. Rev. Rul. 85-97, 1985-2 C.B. 50.

The assertion of Petitioner United States that the injury in the underlying Title VII case was to economic interests simply begs the question whether invidious employment discrimination is a personal injury. According to controlling precedents of this Court, the mere fact that economic interests are injured as a result of discrimination does not convert the injury from personal to nonpersonal. Nor does it convert the claim from one sounding in the nature of tort to one based on contract. *Goodman v. Lukens Steel Co.*, 482 U.S. 656, 107 S. Ct. 2617 (1986), fully determined these principles, and there is no need to reconsider them in the present case.

Goodman, a Title VII and 42 U.S.C. § 1981 case brought against the Union and employer for race discrimination in employment, held that the injury suffered was personal, and thus the statute of limitations governing personal injury claims, rather than contract claims, controlled. The petitioners in that case sought to distinguish *Wilson v. Garcia*, 471 U.S. 261, 105 S.Ct. 1938 (1985), which held that § 1983 injuries were personal and tort-like in nature and thus governed by the personal injury limitations period, by arguing that § 1981 dealt with economic rights only. This argument, rejected by the Court, is virtually identical to the position now taken by the United States. The Court held in *Goodman* that "racial discrimination is a fundamental injury to the individual rights of a person." 482 U.S. at 661, 107 S. Ct. at 2621. The fact that a contract was at issue in no way altered this conclusion:

> Insofar as [§ 1981] deals with contracts, it declares the personal right to make and enforce contracts—a right that may not be interfered with on racial grounds. That § 1981 has far-reaching economic consequences does not change this conclusion [that fundamental personal rights are involved], since such impact flows from guaranteeing the personal right to engage in economically significant activity free from racially discriminatory interference.

Id. at 661-62.

This reasoning can be applied verbatim to Title VII. Just as racial discrimination is a fundamental injury to the individual rights of a person, so is sex-based discrimination made actionable by Title VII. Thus, the Sixth Circuit was correct to follow this Court's controlling precedents of *Goodman* and *Wilson* to hold that "injuries resulting from invidious discrimination, be it on the basis of race, sex, national origin or some other unlawful category, are injuries to the individual rights and dignity of the person." 929 F.2d at 1121 (Pet. app. at 6a). As the Tax Court noted in *Metzger*, *supra*, the injuries actionable under Title VII are as much personal injuries as those actionable under its fellow parts of the Civil Rights chapter of the U.S. Code, including §§ 1981 and 1983. 88 T.C. 834, 856 (1987).

The fact that the decision below was dictated by controlling precedents of this Court provides ample reason to deny the writ.

CONCLUSION

The Petition sets forth no basis for review by this Court, since there is not in fact a square conflict between the circuits, and the Sixth Circuit resolved the determinative issue consistently with decisions of this Court and other courts. The Petition should therefore be denied.

Respectfully submitted,

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No. 91-42

In the Supreme Court of the United States

OCTOBER TERM, 1991

UNITED STATES OF AMERICA, PETITIONER

v.

THERESE A. BURKE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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Respondents have offered untenable factual theories and erroneous legal analyses to support their contention (Br. in Opp. 6-10) that the decision below does not conflict with *Thompson* v. *Commissioner*, 866 F.2d 709 (4th Cir. 1989), and with *Johnston* v. *Harris County Flood Control District*, 869 F.2d 1565 (5th Cir. 1989), cert. denied, 493 U.S. 1019 (1990).

1. Respondents claim that the income they received in settlement of their Title VII sex discrimination claims represents an award of "litigation benefits" rather than an award of "back pay" (Br. in Opp. 9). This alleged factual distinction is without substance.

The "litigation benefit" that was sought in the Title VII sex discrimination case was an "order awarding back pay to all affected female employees" (Pet. App. 3a, 22a). The only "litigation benefit"

that respondents *could* properly have obtained in the form of a monetary recovery under Title VII was an award of "back pay." See, *e.g.*, *Walker* v. *Ford Motor Co.*, 684 F.2d 1355, 1363-1364 (11th Cir. 1982) (general compensatory and punitive damages are not available under Title VII); Pet. 12-13. Respondents thus received precisely the "litigation benefit" that they sought: an award of "back pay."

2. Respondents similarly err in claiming that *Johnston* v. *Harris County Flood Control District*—in which the Fifth Circuit held that a recovery of back pay under Title VII "is not tax-exempt" (869 F.2d at 1580)—"has little relevance" to this case (Br. in Opp. 10). As respondents correctly observe (*ibid.*), *Johnston* involved a judicial determination of a Title VII back pay claim rather than a voluntary settlement of one. Respondents are clearly incorrect, however, in suggesting that this purported distinction makes *Johnston* of "little relevance" (*ibid.*). The tax treatment of a recovery for "personal injuries or sickness" under Section 104(a)(2) depends on the nature of the claim, not on whether the recovery is awarded by a court or paid pursuant to a voluntary settlement agreement. By its very terms, Section 104(a)(2) applies to "damages received (*whether by suit or agreement* * * *) on account of personal injuries or sickness." 26 U.S.C. 104(a)(2) (emphasis added). Respondents' proposed distinction of *Johnston* as a case involving a "trial court [determination of] the amount of back wages" instead of a "settlement" (Br. in Opp. 10) simply ignores the plain language of the statute.

3. In attempting to distinguish *Thompson* v. *Commissioner*, respondents claim that *Thompson* was "essentially" about back pay awarded under the Equal Pay Act and involved no "probing consideration" of

the tax treatment of back pay awarded under Title VII (Br. in Opp. 7). Respondents hypothesize that the *Thompson* court's failure to give a "probing consideration" of the income tax treatment of back-pay recoveries under Title VII occurred because it "was only coincidental" that the Equal Pay Act violation in *Thompson* "also happened" to be a violation of Title VII (Br. in Opp. 7).

We do not agree that the holding of the court of appeals in *Thompson* was the result of either coincidence or judicial carelessness. Nor do we agree that respondents have offered a "fair reading" (Br. in Opp. 7) of that decision. To the contrary, the Fourth Circuit observed in no less than *five* separate passages that *Thompson* involved back pay awarded under *both* Title VII and the Equal Pay Act (866 F.2d at 710-711). Having noted that back pay under *both* statutes was involved, the court then concluded generally that "the claim for back pay was essentially a contractual claim for accrued wages" and was therefore not excluded from income by Section 104(a)(2). *Id.* at 712.

Like Judge Wellford in his dissent in this case, we believe that *Thompson* offered a "better reasoned analysis" (Pet. App. 16a) of the proper tax treatment of back-pay recoveries under Title VII. Whether or not one agrees that *Thompson* correctly decided this issue, however, what is clear is that *Thompson did* decide this issue. Respondents simply err in contending to the contrary.

4. Finally, without even considering the seventy-five-year-long history of administrative interpretation of Section 104(a)(2)—which is recounted in some detail in the petition (Pet. 6-10)—respondents erroneously claim (Br. in Opp. 12-16) that the government's position in this case is foreclosed under

Treasury regulations that interpret the statute to exclude from income any recovery of damages for personal, "tort type" injuries. See Treas. Reg. § 1.104-1(c). While respondents' argument is not convincing for reasons discussed in the petition (Pet. 6-16 & n.10), it suffices here to note that the Internal Revenue Service has long interpreted this regulation to be inapplicable to statutory "back pay" remedies because they are contract-like, rather than "tort type," claims. See Pet. 11 (citing Rev. Rul. 72-341, 1972-2 C.B. 32 (Title VII back pay award is includable in gross income); Rev. Rul. 75-64, 1975-1 C.B. 16 (same for NLRB back-pay award); Rev. Rul. 72-268, 1972-1 C.B. 313 (same for Fair Labor Standards Act back-pay award)). This Court has often held that the agency's interpretation of its own regulation is the "ultimate criterion" for its proper application and is entitled to "controlling weight" where "the meaning of the words used [in the regulation] is in doubt" (*Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945)). See also *North Haven Board of Education* v. *Bell*, 456 U.S. 512, 538 n.29 (1982) ("In construing regulations, the Court normally defers to the agency's interpretation."); *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980) (agency interpretation of its own regulation upheld "[u]nless demonstrably irrational").

The court of appeals improperly disregarded this settled principle in discounting the agency's long-standing interpretation of its regulation.* Because

* We acknowledge that the reference in this regulation to "tort type remedies provides little concrete guidance to the courts. It does little to embellish the language of the statute itself, which excludes damages received for "personal injuries or sickness" from income (26 U.S.C. 104(a)(2)). Our point is not that the regulation is dispositive of the issues in this case but that the court below erred in purporting to *apply* this regulation while choosing to *ignore* the agency's long-standing interpretation of the regulation (see Pet. App. 5a, 8a-10a). This aspect of the decision below quite directly conflicts with this Court's decisions in *Bowles*, *North Haven* and *Ford Motor Credit*.

the decision below conflicts both with the agency's settled interpretation of its regulation and with the interpretation of Section 104(a)(2) that has been adopted by other courts of appeals, the tax treatment of back-pay awards received under a broad variety of federal and state statutes will remain subject to continuing uncertainty and disparate treatment in the absence of a decision by this Court.

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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Solicitor General

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QUESTION PRESENTED

Whether payments received in settlement of back-wage claims under Title VII of the Civil Rights Act of 1964 are excluded from the claimant's gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is reported at 929 F.2d 1119. The opinion of the district court (Pet. App. 18a-34a) is unofficially reported at 90-1 U.S.T.C. ¶ 50,203.

JURISDICTION

The judgment of the court of appeals was entered on April 5, 1991. The petition for a writ of certiorari was filed on July 5, 1991, and was granted on October 7, 1991. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

Section 104 of the Internal Revenue Code, 26 U.S.C. 104, provides in pertinent part:

> Compensation for injuries or sickness
>
> (a) In General.
>
> Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—
>
> * * * * *
>
> (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness;
>
> * * * * *

STATEMENT

1. Respondents are employees of the Tennessee Valley Authority (TVA) and members of the Office and Professional Employees International Union, AFL-CIO (OPEIU).[1] In 1984, Judy A. Hutcheson, a TVA employee, filed an action alleging that TVA had engaged in unlawful sex discrimination in the payment of salaries, in violation of Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e *et seq.* OPEIU intervened in the action in its representational capacity on behalf of respondents and other employees of TVA. Pet. App. 2a; C.A. App. 16.[2]

[1] Respondents are Therese A. Burke, Cynthia R. Center, and Linda G. Gibbs.

[2] References to C.A. App. in this Brief are to the appendix filed in the court of appeals.

Hutcheson and OPEIU alleged that TVA discriminated against female employees in 1981 when it increased the salaries of employees in male-dominated pay schedules and either left salaries of employees in female-dominated pay schedules unchanged or lowered them. Pet. App. 2a-3a; C.A. App. 20-34. The complaint alleged that TVA had "a policy and practice of unlawful, gender-based discrimination with respect to salary" (Pet. App. 20a; C.A. App. 27) and that its conduct was "intended to and did result in disparate treatment of its female employees in their rates of pay in violation of Title VII of the Act" (Pet. App. 22a; C.A. App. 32). The plaintiffs sought an order restraining further discrimination and "a further order awarding back pay to all affected female employees * * * in an amount * * * sufficient to eliminate discrimination" (Pet. App. 22a; C.A. App. 34).

TVA filed a counterclaim against OPEIU alleging fraud, misrepresentation, breach of contract, conspiracy with intent to defraud TVA, and interference with contractual relationships. Pet. App. 3a; C.A. App. 35-56. After the plaintiffs' claim and TVA's counterclaim survived motions for summary judgment, the parties agreed to settle the case. Pet. App. 3a. Pursuant to the settlement agreement, TVA agreed to pay $4200 to Hutcheson and a total of $5,000,000 to affected TVA employees under a formula based on length of service and rates of pay (*id.* at 3a, 23a; C.A. App. 76-77).[3] It was stipulated,

[3] The settlement agreement was signed on March 13, 1987 (Pet. App. 23a; C.A. App. 68-75), and an amendment to the agreement was signed on May 6, 1987 (Pet. App. 24a; C.A. App. 76-79). The settlement agreement, as amended, provides that settlement payments are to be made to all affected per-

however, that TVA would distribute money to individuals only after it first withheld all applicable federal income taxes and FICA (social security) taxes from the payments (Pet. App. 25a; C.A. App. 76-77, 88).[4]

Based upon their lengths of service and rates of pay, respondents Burke, Carter, and Gibbs were entitled to receive, respectively, $764.94, $927.55, and $572.95 under the settlement agreement. TVA withheld federal income tax and FICA tax from these amounts and remitted the taxes to the United States. Pet. App. 25a. The net balance of the settlement amounts was then paid to respondents (C.A. App. 17-18).

2. Respondents filed refund claims with the Internal Revenue Service for the taxes withheld from the settlement payments (C.A. App. 7-9). The Internal Revenue Service disallowed the claims (C.A. App. 10-14). Respondents then commenced this refund action in the United States District Court for the Eastern District of Tennessee, claiming that the settlement payments should be excluded from their gross incomes under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)). C.A. App. 2-5.

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sons who were employed "at any time between June 28, 1981, through and including March 10, 1987" (Pet. App. 25a; C.A. App. 77). The agreement further provides that the amounts to be paid to the affected employees "will be based upon pay rates and length of service * * * during the above period" (C.A. App. 77).

[4] The settlement agreement provides that "TVA will pay at OPEIU's direction a sum not to exceed $5,000,000, less any taxes which TVA may be required to pay because it is the employer of any person whom OPEIU may designate to receive a portion of said sum" (Pet. App. 24a; C.A. App. 76-77).

The district court rejected respondents' claims (Pet. App. 18a-34a). The court observed that several courts have held that Title VII back pay awards do not constitute damages for "personal injuries or sickness" (*id.* at 31a-34a, citing, *e.g.*, *Thompson* v. *Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989); *Hodge* v. *Commissioner*, 64 T.C. 616, 618-620 (1975)) and that the complaint in the underlying Title VII action "makes it clear that the very core of the case was the recovery of wage deficiencies" (Pet. App. 32a). Finding that the plaintiffs had "tacitly accepted that the sums to be received under the Settlement Agreement were in the nature of back pay" (*id.* at 34a), the court concluded that the amounts received by respondents were not excluded from gross income under Section 104(a)(2) (Pet. App. 34a).

3. A divided court of appeals reversed (Pet. App. 1a-17a). The panel majority stated that the question "whether the § 104(a)(2) exclusion applies requires an examination of the nature of the injury to determine whether the injury and claim are personal and tort-like in nature" (*id.* at 6a). The court concluded that a sex discrimination claim is tort-like in nature because "injuries resulting from invidious discrimination, be it on the basis of race, sex, national origin or some other unlawful category, are injuries to the individual rights and dignity of the person" (*ibid.*). The court of appeals had previously held in *Pistillo* v. *Commissioner*, 912 F.2d 145 (6th Cir. 1990), that an award of back pay under the Age Discrimination in Employment Act, 29 U.S.C. 621-634, constituted damages for "personal injuries or sickness" excluded from income under Section 104(a)(2). The court found no basis for distinguishing *Pistillo* from the present case (Pet. App. 7a-11a) and thus concluded that "suits for unlawful discrimination under Title

VII, like suits under the ADEA and other tort type suits, fall within the category of suits for injury to the person and that the damages resulting therefrom are properly excludable under § 104(a)(2)" (*id.* at 11a).

In dissent (Pet. App. 12a-17a), Judge Wellford observed that "[t]he subject matter of the [underlying Title VII] suit was pay for work performed" (*id.* at 12a) and that respondents "obviously recovered amounts which would have been subject to income tax had they come to [respondents] in the normal course" (*id.* at 14a). Judge Wellford noted (*id.* at 15a) that the Fourth Circuit had held in *Thompson* v. *Commissioner*, 866 F.2d 709 (1989), that a Title VII back pay award is not excludable under Section 104(a)(2), because "[t]he back pay award was simply recovery for earned, but unpaid, wages" and represented "compensation for services rendered" (866 F.2d at 712). Because Judge Wellford found the Fourth Circuit's analysis of this issue "to be both logical and compelling," he concluded that the "flawed analysis" of *Pistillo* should not be extended to this case (Pet. App. 15a).

SUMMARY OF ARGUMENT

Section 104(a)(2) of the Internal Revenue Code excludes from gross income "the amount of any damages received (whether by suit or agreement * * *) on account of personal injuries or sickness." Respondents received payments from their employer as part of a settlement of an action brought under Title VII of the Civil Rights Act of 1964. The Title VII action was based on the allegation that the manner in which the employer established salary schedules for different job categories resulted in gender discrimination in the payment of salaries. The only monetary relief sought in the underlying Title VII action, and the only relief available in that action, was back pay. Amounts received in settlement of a claim are treated for tax purposes as having the same character as the claim itself. Accordingly, the amounts received by respondents are treated for tax purposes as Title VII back pay.

As this Court noted in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 432 n.8 (1955), the rationale of Section 104(a)(2) is that no gain or profit is realized from compensation that merely restores personal "capital" lost through injury, such as an award of damages for injury to a human body or for injury to personal reputation in a defamation case. It is not supportable, however, to view the receipt of back wages (which would have been taxed as income if received currently during the course of employment) as compensation for lost personal capital. Since a Title VII back pay award such as that at issue here is not an award of damages that compensates for an injury to one's personal capital, but represents an undeniable accession to wealth in the form of deferred wages for services actually provided, it represents taxable income.

The injury suffered by respondents (and the injury for which they were compensated under Title VII) was an injury to their economic interests relating to the amount of their salaries. If respondents' salaries had been increased in the same manner as the salaries of employees in the male-dominated job categories were increased, then there would have been no Title VII violation, no injury, and no Title VII claim. The settlement payments that respondents received represent the recovery of earned, but unpaid, wages. They

therefore constitute "[c]ompensation for services" and are expressly included in gross income by Section 61 (a) (1) of the Internal Revenue Code.

The conclusion that Title VII back pay is not to be excluded from gross income is wholly in accord with the policies fostered by Title VII. The remedies available under Title VII are designed to make persons whole for injuries suffered on account of unlawful employment discrimination. A Title VII back pay award is thus designed to place the employee in the same economic position she would have achieved had she not been discriminated against in the first place. If respondents' employer had not discriminated against respondents in the present case, they would have received higher salaries, and those salaries would have been included in their gross incomes. Requiring respondents to pay taxes on their back pay awards accomplishes the objectives of Title VII by placing respondents in the same position they would have held if there had been no discrimination.

ARGUMENT

PAYMENTS RECEIVED IN SETTLEMENT OF BACK-WAGE CLAIMS UNDER TITLE VII OF THE CIVIL RIGHTS ACT OF 1964 ARE NOT EXCLUDED FROM GROSS INCOME UNDER SECTION 104(a)(2) OF THE INTERNAL REVENUE CODE AS "DAMAGES RECEIVED * * * ON ACCOUNT OF PERSONAL INJURIES OR SICKNESS"

A. Section 104(a)(2) Excludes From Gross Income Payments Received By Individuals That Restore The Losses They Suffer "On Account Of Personal Injuries Or Sickness"

The first step in calculating taxable income under the Internal Revenue Code is to determine the taxpayer's "gross income." Section 61(a) provides broadly that, subject to specific exclusions set forth elsewhere in the Code, "gross income means all income from whatever source derived." Any funds or other "accessions to wealth" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 430-431 (1955)) received by a taxpayer therefore represent "gross income" unless the taxpayer establishes that the income falls within one of the specific exclusions created by other sections of the Code.

It is not disputed that the payments received by respondents in settlement of their sex-discrimination claims under Title VII of the Civil Rights Act of 1964 represent an "accession to wealth" that constitutes "gross income" within the broad scope of Section 61(a). The question presented in this case is whether these settlement payments are excluded from "gross income" by Section 104(a)(2), which provides that "gross income does not include * * * the amount of

any damages received (whether by suit or agreement * * *) on account of personal injuries or sickness." [5]

This exclusionary provision was first enacted as Section 213(b)(6) of the Revenue Act of 1918, ch. 18, 40 Stat. 1066. The purpose of the statute was to implement this Court's then-recent holding in *Doyle* v. *Mitchell Brothers Co.*, 247 U.S. 179, 183, 185 (1918), that amounts received from the "conversion" of capital assets into money represented "income" only to the extent that a "gain" was realized from the transaction.[6] "Applying this decision, the Attorney General held in an opinion, dated June 2[6], 1918, that the proceeds of an accident insurance policy were not subject to tax, the conclusion being based upon the reasoning that the human body is a kind of capital and that the proceeds of the insurance policy represented a conversion of the capital lost through the in-

[5] Section 104(a)(2) concerns exceptions from "gross income" for income tax purposes. The taxpayers in this case also seek recovery of FICA contributions (Pet. App. 18a), which are "imposed on the income of every individual" and are calculated upon an employee's "wages." 26 U.S.C. 3101(a). Neither the parties nor the courts below separately addressed whether Section 104 applies to FICA as well as income tax computations. If, as we submit, back pay received under Title VII constitutes "compensation for services" and falls within "gross income" under Section 61(a) of the Code, it also constitutes "wages" for FICA purposes. See 26 U.S.C. 3121(a) (" 'wages' means all remuneration for employment").

[6] *Doyle* v. *Mitchell Brothers Co.* was decided under the Corporation Tax Act of 1909, ch. 6, § 38, 36 Stat. 112. The Court defined income as "the gain derived from capital, from labor, or from both combined." 247 U.S. at 185 (quoting *Stratton's Independence, Ltd.* v. *Howbert*, 231 U.S. 399, 415 (1913)). Two years later, the Court used this same definition of "income" in interpreting the scope of the Sixteenth Amendment. See *Eisner* v. *Macomber*, 252 U.S. 189, 207 (1920).

jury." S. 1384, 2 C.B. 71, 72 (1920) (citing 31 Op. Att'y Gen. 304 (1918)). The rationale for the statute, which "intended to go no further" (S. 1384, 2 C.B. at 72), was thus that type of harm to the human body that gives rise to recoveries of workmen's compensation or health insurance payments, or to damage awards for "such injuries or sickness," did not represent "income" as the term was then defined. H.R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1918).[7]

In the first ruling issued by the Internal Revenue Service under this statute,[8] it was therefore concluded that, while nonphysical injuries (such as alienation of affections) could be regarded in some sense as

[7] The Treasury had initially taken the position that amounts paid under accident insurance policies and amounts received in a suit for personal injury were includable in income. T.D. 2135, 17 Treas. Dec. Int. Rev. 39 (1915). In 1918, however, after this Court's decision in *Doyle* v. *Mitchell Brothers Co.*, *supra*, the Attorney General issued the aforementioned opinion that such recoveries should be excluded from income because they "merely take the place of capital in human ability which was destroyed by the accident." 31 Op. Att'y Gen. at 308. The Treasury then ruled that "the proceeds of an accident insurance policy received by an individual on account of personal injuries sustained by him through accident" and "an amount received by an individual as the result of a suit or compromise for personal injuries sustained by him through accident" were not income. T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918). Congress enacted Section 213(b)(6) because "[u]nder the present law it is doubtful whether [amounts received from health insurance, workmen's compensation or as damages on account of personal injuries] are required to be included in gross income." H.R. Rep. No. 767, *supra*, at 9-10.

[8] The Internal Revenue Service was known at that time as the Bureau of Internal Revenue. For continuity of discussion, this brief refers to both the Bureau of Internal Revenue and the Internal Revenue Service as "the Service."

"personal" injuries, they are nonetheless not within the statutory exclusion from income because "the term 'personal injuries,' as used therein means physical injuries only." S. 1384, 2 C.B. at 71; see *id.* at 72.[9]

In 1922, however, the Service reconsidered whether recoveries for alienation of affections (and other nonphysical injuries to personal rights) were taxable and ruled that, while they are not excluded from income by (what is now) Section 104(a)(2), they nonetheless do not represent "income" because, when an individual receives damages that merely compensate him for loss suffered to a "personal right," "it can not be held that he thereby derives any gain or profit." S. 132, I-1 C.B. 92, 93 (1922) (citing *Eisner* v. *Macomber*, 252 U.S. 189 (1920)).[10] Because there is no gain or profit in such compensation, such recoveries were thought not to represent "income within the meaning of the sixteenth amendment and the statutes enacted thereunder." I-1 C.B. at 93-94. Thus, even though the exclusion from income afforded to compensation for "personal injuries or sickness" under (what is now) Section 104(a)(2) was not applicable to compensation received for a nonphysical injury to personal rights, the Service ruled that such compensation was not taxable because no "income" had resulted. I-1 C.B. at 93-94. See Knickerbocker, *The Income Tax Treatment of Damages: A Study in the Difficulties of the Income Concept*, 47 Corn. L. Q. 429, 430-434 (1961).

[9] While the Service thus rejected a claim that the tort of alienation of affections represented a "personal injury" within the scope of the statute, the Service recognized that "it is still possible that damages therefor might be measured in part by sickness resulting therefrom and, of course, the amount received on account of sickness would be exempt under the express language of the statute." S. 1384, 2 C.B. at 72.

[10] This ruling was issued in the form of a Solicitor's Opinion, which corresponds to a revenue ruling under modern practice. See 26 C.F.R. 601.201(a)(6).

In 1955, however, this Court made clear that the term "income" is not limited to earnings and profits from labor and capital but includes all "accessions to wealth" from whatever source derived. *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 431. As a result, there is now no constitutional impediment to taxing personal injury damages. See B. Bittker & L. Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 13.1.1, at 13-2 (2d ed. 1989).[11] In *Glenshaw Glass*, however, the Court did not reject the Service's longstanding position that the recovery of damages for personal claims would not represent "income" under the Internal Revenue Code to the extent that such recoveries "correspond to a return of capital." 348 U.S. at 432 n.8, citing, *e.g.*, S. 132, I-1 C.B. 92, 93.[12]

Since the decision in *Glenshaw Glass*, the proper focus for the inquiry whether recoveries for non-

[11] See also *Lukhard* v. *Reed*, 481 U.S. 368, 374-376 (1987) (plurality opinion) (a state may treat personal injury awards as "income" for purposes of determining the eligibility of families seeking Aid to Families with Dependent Children benefits).

[12] In *Glenshaw Glass*, the Court held that punitive damages are included in income. The Court noted that "[t]he long history of departmental rulings holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages following injury to property" because "[d]amages for personal injury are by definition compensatory only. Punitive damages, on the other hand, cannot be considered a restoration of capital for taxation purposes." 348 U.S. at 432 n.8.

physical injuries to personal rights are subject to tax is thus whether the recovery merely represents compensation, without "any gain or profit" (S. 132, I-1 C.B. at 93), for human "capital lost through * * * injury" (S. 1384, 2 C.B. at 72). As Judge Browning stated for the court in *Starrels* v. *Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962), "[d]amages paid for personal injuries are excluded from gross income because they make the taxpayer whole from a previous loss of personal rights—because, in effect, they restore a loss of capital." Accord, *Commissioner* v. *Miller*, 914 F.2d 586, 590 (4th Cir. 1990).[13] For Section 104(a)(2) to be applicable to a recovery involving a non-physical injury to personal rights, the taxpayer therefore has the burden of establishing that the recovery is reimbursement for a prior loss of personal

[13] In 1983, the Ninth Circuit held in a case involving defamation that both physical and nonphysical injuries are encompassed within the Section 104(a)(2) exclusion. See *Roemer* v. *Commissioner*, 716 F.2d 693, 697 (9th Cir. 1983). See also Pet. App. 5a (adopting same reasoning). The only support offered for this holding in *Roemer* was that the 1922 Solicitor's Opinion had concluded that recoveries for nonphysical injuries did not represent "income." See 716 F.2d at 697 (citing S. 132, I-1 C.B. at 92). As we have shown, however, the 1922 Solicitor's Opinion had instead observed that nonphysical injuries were not encompassed within the statutory exclusion but were nonetheless not taxable to the extent that they merely compensate for a loss to human capital and represent no gain or profit. See I-1 C.B. at 92. Although the Service has not formally acquiesced in *Roemer*, it no longer contends that only physical injuries are encompassed within Section 104(a)(2). See Rev. Rul. 85-143, 1985-2 C.B. 55; Rev. Rul. 85-98, 1985-2 C.B. 51. Instead, the focus of the inquiry is whether a recovery for a claim of nonphysical injury compensates for a personal loss or represents an economic gain. See *Commissioner* v. *Miller*, 914 F.2d at 590.

"capital" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 432 n.8) and does not represent gain or profit that "instead add[s] to [her] wealth." *Starrels* v. *Commissioner*, 304 F.2d at 576.

B. The Settlement Payments Received By Respondents Represent An Enhancement Of Their Wealth That Is Not Excluded From Income By Section 101(a)(2)

1. *The back pay awarded to respondents under Title VII of the Civil Rights Act of 1964 represented compensation for work already performed*

The payments received by respondents were made by their employer in settlement of sex-discrimination claims under Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e *et seq.* The Title VII action was based on the allegation that the employer had altered salary schedules for various job categories in a manner that effected a gender-based discrimination in the payment of salaries. Pet. App. 19a-21a; C.A. App. 25-31. The complaint sought relief in the form of back pay for all affected female employees (including respondents) and a prospective, curative adjustment of the pay schedules. Pet. App. 22a; C.A. App. 33-34.

Title VII makes it an unlawful employment practice for an employer "to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin." 42 U.S.C. 2000e-2(a). An aggrieved employee may, if administrative remedies are unsuccessful, file suit in a district court. 42 U.S.C. 2000e-5(f)(1). If the court finds that the employer has engaged in an unlawful employment practice, it may enjoin the practice and "order such affirmative ac-

tion as may be appropriate, which may include, but is not limited to, reinstatement or hiring of employees, with or without back pay * * * or any other equitable relief as the court deems appropriate." 42 U.S.C. 2000e-5(g). Successful plaintiffs in a Title VII action involving salary discrimination may recover back pay in the amount of the differential between the salary received and the salary that would have been paid but for the discrimination. See *Rasimas* v. *Michigan Dep't of Mental Health*, 714 F.2d 614, 626 (6th Cir. 1983), cert. denied, 466 U.S. 950 (1984). Because Title VII allows only "equitable" relief, however, it is well settled that general compensatory damages and punitive damages are not available under Title VII. *E.g.*, *Walker* v. *Ford Motor Co.*, 684 F.2d 1355, 1363-1364 (11th Cir. 1982); *DeGrace* v. *Rumsfeld*, 614 F.2d 796, 808 (1st Cir. 1980); see *Patterson* v. *McLean Credit Union*, 491 U.S. 164, 182 n.4 (1989); *Great American Federal Savings & Loan Ass'n* v. *Novotny*, 442 U.S. 366, 375 (1979).[14]

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[14] Some Title VII plaintiffs can recover an award of future lost earnings (front pay). This remedy applies in cases where the employee-plaintiff was discharged and the statutory remedy of "reinstatement" (42 U.S.C. 2000e-5(g)) is not feasible. See, *e.g.*, *Shore* v. *Federal Express Corp.*, 777 F.2d 1155, 1158-1160 (6th Cir. 1985). Since the court in a Title VII salary discrimination case can order the defendant to pay a nondiscriminatory salary in the future, an award of front pay would seldom be appropriate. The plaintiffs here did not seek front pay, so no part of the settlement could represent front pay. A Title VII plaintiff may also recover a monetary award to account for lost fringe benefits such as vacation pay and pension benefits. See, *e.g.*, *Rasimas* v. *Michigan Dep't of Mental Health*, 714 F.2d at 626. The plaintiffs did not seek such fringe benefits in this case.

The only monetary relief available, and the only monetary relief sought, in the underlying Title VII action was "back pay to all affected female employees * * * in an amount * * * sufficient to eliminate discrimination" (Pet. App. 22a; C.A. App. 34). As the district court concluded, "the very core of the case was recovery of wage deficiencies" (Pet. App. 32a-33a).

Amounts received in settlement of a claim are treated for tax purposes as having the same character as the claim itself. *E.g.*, *Lyeth* v. *Hoey*, 305 U.S. 188, 196 (1938) (amount received by taxpayer in settlement of will contest is treated in same manner as if "the contest had been fought to a finish and petitioner had succeeded"); *Elrick* v. *Commissioner*, 485 F.2d 1049, 1058 (D.C. Cir. 1973); *Thomson* v. *Commissioner*, 406 F.2d 1006, 1008 (9th Cir. 1969); *Commissioner* v. *Murdoch*, 318 F.2d 414, 416 (3d Cir. 1963), cert. denied, 375 U.S. 879 (1963). The settlement payments received by respondents must therefore be regarded for tax purposes as an award of back pay, just as if the Title VII action had been concluded and the plaintiffs had prevailed.

Respondents claim that the payments under the settlement agreement represent "litigation benefits" (C.A. App. 71) rather than an award of back pay (Br. in Opp. 9; see *id.* at 4-5). This claim is without substance. The "litigation benefit" that was sought in the underlying Title VII action was an "order awarding back pay to all affected female employees" (Pet. App. 22a), and the only "litigation benefit" that respondents *could* properly have obtained in the form of a monetary recovery was an award of back pay. Respondents thus received precisely the "litigation benefit" that they sought: an award of back pay under Title VII.

2. *Compensation for work already performed represents an enhancement of wealth*

An award of back pay designed to recover "wage deficiencies" (Pet. App. 32a-33a) represents enhanced compensation for work already performed. Such enhanced compensation constitutes an "accession[] to wealth" rather than the recovery of lost personal "capital" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 431, 432 n.8).

Under the rationale that no "gain or profit" is realized when compensation is received for personal "capital lost through injury" (see S.1384, 2 C.B. at 72), it is appropriate (for example) to recognize no income from a recovery for defamation of one's character or injury to one's "personal reputation." See, *e.g.*, *Hawkins* v. *Commissioner*, 6 B.T.A. 1023, 1024-1025 (1927). The receipt of monetary compensation in exchange for such lost "personal capital," which merely makes "the plaintiff whole as before the injury" (*id.* at 1025), represents an exchange without gain or profit. *Ibid.* See *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 432 n.8 ("[d]amages for personal injury are by definition compensatory only"). It is not supportable, however, to view the receipt of back wages (which would have been taxed as income if received currently during the course of employment) as compensation for lost personal capital. Back wages for work already performed do not compensate for a loss, but represent an "undeniable accession[] to wealth" (*id.* at 431) for the recipient.

For this reason, the Service has long ruled that amounts awarded as overtime compensation and unpaid minimum wages under the Fair Labor Standards Act are included in gross income. Rev. Rul. 72-268, 1972-1 C.B. 313; Rev. Rul. 55-203, 1955-1 C.B. 114; Mim. 6028, 1946-2 C.B. 130; I.T. 3742, 1945

C.B. 320; S.S.T. 393, 1940-1 C.B. 213. The Service has also concluded that back pay awarded under the National Labor Relations Act is included in gross income. Rev. Rul. 75-64, 1975-1 C.B. 16; Rev. Rul. 57-55, 1957-1 C.B. 304; Mim. 6040, 1946-2 C.B. 155. Similarly, this Court has held, in an unlawful discharge case, that back pay awarded under the National Labor Relations Act represents "wages" for purposes of the Social Security Act. *Social Security Board* v. *Nierotko*, 327 U.S. 358, 363-366 (1946).[15] An award of back pay is "merely a substitute for" (*Hort* v. *Commissioner*, 313 U.S. 28, 31 (1941)) compensation owed for services performed; it therefore constitutes income under Section 61(a). See *Hort* v *Commissioner*, 313 U.S. at 32.

Applying this same principle, the Service has correctly ruled that a Title VII back pay award is included in gross income. Rev. Rul. 72-341, 1972-2 C.B. 32. As the Service stated in its Ruling, "since the payments made by the corporation to the employees * * * were based on compensation that they otherwise would have received, the amount of the payments are includible in their gross incomes as compensation under Section 61 of the Code." *Ibid.*

The Service's longstanding ruling that Title VII back pay is included in gross income should be given substantial deference. See *National Muffler Dealers*

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[15] In *Nierotko*, the Court rejected the contention that a back pay award "is more appropriately classified as in the nature of damages and reparation for loss than as remuneration for service performed." *Nierotko* v. *Social Security Board*, 149 F.2d 273, 275 (6th Cir. 1945), aff'd, 327 U.S. 358 (1946). That rationale, rejected by this Court in *Nierotko*, is the very rationale applied by the court of appeals in this case in holding that Title VII back pay constitutes damages for personal injury. See Pet. App. 6a-10a.

Ass'n v. *United States*, 440 U.S. 472, 476-477 (1979). See also *Cottage Savings Ass'n* v. *Commissioner*, 111 S. Ct. 1503, 1509 n.7 (1991). An award of back pay under Title VII does not constitute a recovery of "damages, but rather is an integral part of the statutory equitable remedy." *Johnson* v. *Georgia Highway Express, Inc.*, 417 F.2d 1122, 1125 (5th Cir. 1969). See *Robinson* v. *Lorillard Corp.*, 444 F.2d 791, 802 (4th Cir.) (same), cert. dismissed, 404 U.S. 1006 (1971); *EEOC* v. *Detroit Edison Co.*, 515 F.2d 301, 308 (6th Cir. 1975) ("[b]ack pay in Title VII cases is considered a form of restitution, not an award of damages"), vacated and remanded on other grounds, 431 U.S. 951 (1977). Since a Title VII back pay award is not an award of damages that compensates for a prior loss of personal capital, but, instead, represents an undeniable accession to wealth in the form of deferred wages, it constitutes income to the taxpayer. See *Starrels* v. *Commissioner*, 304 F.2d at 576.

3. *The court of appeals erred in refusing to apply the foregoing principles*

a. The court of appeals did not dispute that the settlement payments in this case represented back pay for services already performed. See Pet. App. 9a-10a. Instead, the court concluded that these payments were excluded from income under Section 104(a)(2) on the theory that discrimination is an inherently "personal" injury, involving "individual rights and dignity of the person," and that *any* compensation associated with findings of discrimination therefore falls within the scope of the statute (Pet. App. 5a-8a). This ostensibly "literal" interpretation of the statute is incorrect.

It is well established that provisions exempting income from taxation "are to be construed narrowly." *United States* v. *Centennial Savings Bank*, 111 S. Ct. 1512, 1519 (1991) (citing, *e.g.*, *Commissioner* v. *Jacobsen*, 336 U.S. 28, 49 (1949)). Any unsatisfied claim of an individual—whether based on statute, contract, tort or other legal principle—could in some sense be said to be a "personal" claim. The issue that Section 104(a)(2) has addressed from its first enactment is whether the recovery obtained makes the individual whole for a preexisting personal loss or provides a benefit that increases the wealth of that individual. See pp. 10-15, *supra*. An award of back pay for work already performed, like any other "[c]ompensation for services" (26 U.S.C. 61(a)), is specifically included in "gross income" under Section 61(a) of the Code. Such an award represents an accession to wealth, rather than compensation for a loss, as the Service has consistently concluded.[18]

[18] Although the Service has ruled that damages for a physical injury that prevents an individual from engaging in employment may come within the Section 104(a)(2) exclusion (Rev. Rul. 85-97, 1985-2 C.B. 50; Rev. Rul. 61-1, 1961-1 C.B. 14), those rulings have no application here. In those situations, where the employee has been rendered incapable of performing work, the award of damages (including an award for lost future income due to the inability to perform work) represents "a restoration of [personal] capital" that is "by definition compensatory only." *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 432 n.8. By contrast, a back pay award for services already performed is an accretion to the taxpayer's wealth that "cannot be considered a restoration of capital for taxation purposes" (*ibid.*) and therefore does not fall within Section 104(a)(2).

Moreover, in a case where an employee has been rendered physically incapable of performing work, the award of damages is calculated with consideration of the fact that it is

b. In an effort to provide useful, categorical guidance, Treasury regulations adopted under Section 104(a)(2) indicate that the statute applies to amounts received "through prosecution of a legal suit or action based upon tort or tort type rights." Treas. Reg. § 1.104-1(c). The agency has long concluded, however, that back pay recoveries under Title VII and similar statutes are not excluded from gross income because they represent "remuneration for services." See Rev. Rul. 72-341, 1972-2 C.B. at 32. The court of appeals erred in disregarding the agency's application of its own regulation (Pet. App. 5a-10a).

The principle of compensation in the common law of torts is "that a person should be compensated fairly for injuries caused by the violation of his legal rights." *Carey* v. *Piphus*, 435 U.S. 247, 257 (1978). Mental and emotional distress and other similar suffering are compensable in tort actions. *Id.* at 264 & n.20; see *Memphis Community School Dist.* v. *Stachura*, 477 U.S. 299, 307 (1986) (compensatory

not subject to taxation. This is necessary to place the worker in the same situation as if she had not suffered the loss in the first place: "Since the damages award is tax-free, the relevant stream [of lost income] is ideally of *after-tax* wages and benefits." *Jones & Laughlin Steel Corp.* v. *Pfeifer*, 462 U.S. 523, 534 (1983). See also *Norfolk & W. R.R.* v. *Liepelt*, 444 U.S. 490, 493-498 (1980).

If a back pay award under Title VII were not subject to tax, such recoveries would similarly be reduced by the amount of the taxes saved. See *Johnston* v. *Harris County Flood Control Dist.*, 869 F.2d 1565, 1580 (5th Cir. 1989), cert. denied, 493 U.S. 1019 (1990); *Sears* v. *Atchison, T. & S.F. Ry.*, 749 F.2d 1451, 1456 (10th Cir. 1984), cert. denied, 471 U.S. 1099 (1985). The employer would then receive a windfall in the amount of the taxes saved. This windfall would create a perverse incentive for the employer to engage in salary discrimination in order to save taxes.

damages may include "such injuries as 'impairment of reputation . . ., personal humiliation, and mental anguish and suffering'" (quoting *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 350 (1974)). These types of compensatory damages for mental and emotional distress are not available under Title VII. See, *e.g.*, *DeGrace* v. *Rumsfeld*, 614 F.2d at 808. A statutory Title VII action thus differs significantly from the tort type rights encompassed within the regulations implementing Section 104(a)(2), and the agency has consistently so ruled.[17]

As this Court has often noted, the agency's interpretation of its own regulation is the "ultimate criterion" for its proper application and is entitled to "controlling weight" where "the meaning of the

[17] Respondents contend that a Title VII claim is "in the nature of tort" because it is not "based on contract." Br. in Opp. 15; see *id.* at 13. But respondents' conclusion does not follow from their premise. The mere fact that a claim is not a contract action does not necessarily make it a tort action. Moreover, the existence of the respondents' employment contracts underlies their claims for wages: the statutory duty not to discriminate, like other forms of legal protection afforded to employees, may be regarded as a condition of that contract implied in law. Indeed, back-pay claims typically are claims for wages prescribed by the employer's contracts of employment.

Respondents also seem to contend that if an action sounds in tort, it must be a personal injury action. Br. in Opp. 12-16. The exclusion for damages received "on account of personal injuries" is not an exclusion for all tort damages. Many tort claims do not involve injuries to the person, but rather injuries to property or other economic interests, *e.g.*, claims for injuries to property, fraud, tortious interference with a contract, and trade libel. Although all "personal injuries" for purposes of Section 104(a)(2) involve tort or tort-like claims, not all tort or tort-like claims involve personal injuries.

words used [in the regulation] is in doubt" (*Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945)). See *North Haven Board of Educ.* v. *Bell*, 456 U.S. 512, 538-539 n.29 (1982) ("In construing regulations, the Court normally defers to the agency's interpretation."); *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980) (agency interpretation of its own regulation upheld "[u]nless demonstrably irrational"). The court of appeals thus plainly erred in purporting to *apply* this regulation—to conclude that respondents' claims were "tort type" in nature and therefore within the scope of Section 104(a)(2) (Pet. App. 5a, 8a-10a)—while choosing to *ignore* the agency's longstanding determination that back pay remedies constitute wage income within the express compass of Section 61(a). See also *Hort* v. *Commissioner*, 313 U.S. at 31-32.

Even if Title VII could properly be regarded as involving a "tort type" right within the meaning of the regulation, back pay would nonetheless not be excludable under Section 104(a)(2) because the injury suffered by respondents (and the injury for which they were compensated under Title VII) was not a personal injury, but rather an injury to their economic interests. See notes 16 & 17, *supra*. As this Court recognized in *Albemarle Paper Co.* v. *Moody*, 422 U.S. 405 (1975), the discrimination addressed by Title VII "deals with legal injuries of an economic character." *Id.* at 418.[18]

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[18] The Court also has recognized that "harassment leading to noneconomic injury can violate Title VII." *Meritor Savings Bank* v. *Vinson*, 477 U.S. 57, 65 (1986). See *Patterson* v. *McLean Credit Union*, 491 U.S. at 180 (racial harassment in the course of employment is actionable under Title VII). In such a case, however, back pay is not an available remedy. See *Meritor Savings Bank*, 477 U.S. at 77 (Marshall, J., concurring) ("In the 'pure' hostile environment case, where an employee files an EEOC complaint alleging sexual harassment in the workplace, the employee seeks not money damages but injunctive relief."); *Bundy* v. *Jackson*, 641 F.2d 934, 946 n.12 (D.C. Cir. 1981) (back pay is "irrelevant to the discriminatory environment issue").

In concluding that Title VII back pay does not constitute damages for personal injuries under Section 104(a)(2), the Fourth Circuit observed in *Thompson* v. *Commissioner*, 866 F.2d 709, 712 (1989), that a Title VII back pay award is "simply recovery for earned, but unpaid, wages" and represent "compensation for services rendered." The Tax Court had earlier reached the same conclusion in *Hodge* v. *Commissioner*, 64 T.C. 616, 619 (1975), observing that "[u]se of the adjective 'back' in the phrase 'back pay' indicates a recovery of wages which should have been paid but were not."[19] Compensation for wages "which

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[19] The Tax Court has followed its decision in *Hodge* in several other cases holding that Title VII back pay is not excludable under Section 104(a)(2). *Thompson* v. *Commissioner*, 89 T.C. 632, 644-648 (1987), aff'd, 866 F.2d 709 (4th Cir. 1989); *Sparrow* v. *Commissioner*, 57 T.C.M. (CCH) 816, 819-821 (1989), appeal pending, No. 90-1151 (D.C. Cir.); *Coats* v. *Commissioner*, 36 T.C.M. (CCH) 1650 (1977); but cf. *Downey* v. *Commissioner*, 97 T.C. 150, 164-170 (1991) (back pay award under Age Discrimination in Employment Act (ADEA), 29 U.S.C. 621-634, is excluded from income under Section 104(a)(2)). The Court of Claims has also held that Title VII back pay is not excludable under Section 101(a)(2). *Watkins* v. *United States*, 80-1 U.S.T.C. ¶ 9362 (Ct. Cl. 1980). Moreover, courts in Title VII cases have taken into account the fact that back pay will be included in the recipient's gross income in fashioning the back pay award. *Johnston* v. *Harris County Flood Control District*, 869 F.2d 1565, 1579-1580 (5th Cir. 1989), cert. denied, 493 U.S. 1019 (1990); *Sears* v. *Atchison, T. & S.F. Ry.*, 749

should have been paid but were not" falls squarely within the category of "[c]ompensation for services" that is expressly included in gross income under Section 61(a)(1) of the Internal Revenue Code.[20]

F.2d 1451, 1456 (10th Cir. 1984), cert. denied, 471 U.S. 1099 (1985); *Melani* v. *Board of Higher Educ.*, 652 F. Supp. 43, 48 (S.D.N.Y. 1986), aff'd mem., 814 F.2d 653 (2d Cir. 1987); see also *Gelof* v. *Papineau*, 829 F.2d 452, 455 (3d Cir. 1987) (ADEA back pay).

[20] Several courts have held that back pay awards under the Age Discrimination in Employment Act (ADEA), 29 U.S.C. 621-634, constitute damages for personal injuries that are excluded from income under Section 104(a)(2). *Redfield* v. *Insurance Co. of North America*, 940 F.2d 542, 545-547 (9th Cir. 1991); *Pistillo* v. *Commissioner*, 912 F.2d 145, 149-150 (6th Cir. 1990); *Rickel* v. *Commissioner*, 900 F.2d 655, 661-664 (3d Cir. 1990); *Downey* v. *Commissioner*, 97 T.C. 150, 164-170 (1991). Each of these cases involved an employee who was discharged by his employer due to unlawful age discrimination. The Ninth Circuit in *Redfield* and the Third Circuit in *Rickel* stated that their decisions were consistent with the Fourth Circuit's decision in *Thompson* because the plaintiff in an employee discharge case receives back pay related to the period *after* he was discharged from his job and, therefore, does not receive compensation for services already performed. *Redfield* v. *Insurance Co. of North America*, 940 F.2d at 546-547 & n.1; *Rickel* v. *Commissioner*, 900 F.2d at 664-665 n.16. There should be no distinction between the receipt of back pay for salary discrimination and for wrongful discharge. Both the ADEA and Title VII prohibit a variety of discriminatory employment practices that can give rise to back pay claims (*e.g.*, discriminatory salary differential, discharge, failure to promote, and failure to hire). See 29 U.S.C. 623(a); 42 U.S.C. 2000e-2(a). In all of these situations, back pay represents "compensation for services" that should have been paid but was not. See *Social Security Board* v. *Nierotko*, 327 U.S. at 363-366 (back pay awarded to employee who was wrongfully discharged by his employer for union activity constitutes wages for purposes of Social Security Act).

c. The court of appeals further erred in disregarding the fact that its ruling would place respondents in a *better* position "than they would have been [in] had the discrimination not occurred" (Pet. App. 9a; *id.* at 10a). The remedies available under Title VII are designed "to make persons whole for injuries suffered on account of unlawful discrimination." *Albemarle Paper Co.* v. *Moody*, 422 U.S. at 418. A Title VII back pay award is required to place the employee in the same economic position she would have achieved had she not been discriminated against in the first place. See *id.* at 418-421. The award, however, should not put the employee in "a better position than [she] would have enjoyed in the absence of discrimination." *Ford Motor Co.* v. *EEOC*, 458 U.S. 219, 234 (1982). See note 16, *supra*.

If respondents' employer had not discriminated against them, they would have received higher salaries and those salaries would have been included in their gross incomes. Requiring respondents to pay taxes on their back pay awards under Title VII simply places them in the same position as if they had not been discriminated against in the first place. By contrast, "[i]f the back pay award were excluded from gross income, [respondents] would be placed at an advantage over [their] male co-workers, who presumably reported their total earned wages as gross income." *Thompson* v. *Commissioner*, 866 F.2d at 712.

The back pay provisions of Title VII were modeled after the back pay provisions of the National Labor Relations Act, 29 U.S.C. 160(b). 110 Cong. Rec. 6549 (1964) (remarks of Sen. Humphrey); *id.* at 7214 (interpretive memorandum by Sens. Clark and Case). See *Albemarle Paper Co.* v. *Moody*, 422 U.S. at 419 & n.11. When Congress enacted Title

VII in 1964, it had already been established that back pay awarded under the National Labor Relations Act was included in gross income for tax purposes. See Rev. Rul. 57-55, 1957-1 C.B. 304; Mim. 6040, 1946-2 C.B. 155; *Social Security Board* v. *Nierotko*, 327 U.S. at 363-366 (back pay constitutes wages for purposes of the Social Security Act). In modeling the back pay provisions of Title VII on the parallel provisions of the earlier statute, Congress did not seek to alter the corresponding conclusion that back pay awarded under Title VII also would be included in gross income and subjected to tax.

d. The court of appeals erred in relying on decisions of this Court dealing with various issues under other statutory remedies for "injuries resulting from invidious discrimination" (Pet. App. 6a). None of the cases cited by the court of appeals even remotely addresses the question whether the injury involved in a Title VII action is a personal injury within the meaning of Section 104(a)(2) of the Internal Revenue Code.

The court of appeals relied (Pet. App. 6a) on *Wilson* v. *Garcia*, 471 U.S. 261 (1985), which held that all claims brought under 42 U.S.C. 1983 should be characterized for statute of limitations purposes as personal injury actions. 471 U.S. at 276, 280. The issue in *Wilson* was what state statute of limitations should be applied to Section 1983 claims. The Court concluded that "federal interests in uniformity, certainty, and the minimization of unnecessary litigation" require that *all* Section 1983 claims be characterized in the same way for limitations purposes and that courts should "select, in each State, the one most appropriate statute of limitations for all § 1983 claims." 471 U.S. at 275. The Court concluded that "the tort action for the recovery of damages for personal injuries is the best alternative available" for characterizing the numerous and various types of recoveries subsumed within Section 1983. 471 U.S. at 276.

The rationale for adopting a blanket rule for statute of limitations purposes under 42 U.S.C. 1983 has no application in the context of Section 104(a)(2). The interests in uniformity, certainty, and the minimization of unnecessary litigation with which the Court was concerned in *Wilson* are absent in the Section 104(a)(2) context. There is no basis whatever to believe that Congress intended that all claims that arise under Section 1983 (which "encompass numerous and diverse topics and subtopics," 471 U.S. at 273) would be characterized as "personal injury" recoveries for tax purposes. For example, this Court recently held that suits for violations of the Commerce Clause may be brought under Section 1983. *Dennis* v. *Higgins*, 111 S. Ct. 865 (1991). Under the rationale of *Wilson* v. *Garcia*, *supra*, such suits would be treated as personal injury actions for statute of limitations purposes. That hardly means that damages that might be recovered in such suits constitute damages for personal injuries for purposes of Section 104(a)(2).

The court of appeals' reliance (Pet. App. 6a) on *Goodman* v. *Lukens Steel Co.*, 482 U.S. 656 (1987), aff'g 777 F. 2d 113 (3d Cir. 1985), is similarly misplaced. In *Goodman*, the Third Circuit held that *Wilson* v. *Garcia* compelled the conclusion that all actions under 42 U.S.C. 1981 should be governed by the statute of limitations for personal injury actions (777 F. 2d at 119-120). This Court agreed. 482 U.S. at 660-662. The *Goodman* decision sheds no light on the proper interpretation of Section 104(a)(2) of the Internal Revenue Code.

The court of appeals also cited (Pet. App. 7a) dictum in *Curtis* v. *Loether*, 415 U.S. 189, 195-196 n.10 (1947), that suggested that an "action to redress racial discrimination may * * * be likened to an action for defamation or intentional infliction of mental distress." In *Curtis*, the Court held that the Seventh Amendment right to jury trial applies to a damages action under the Fair Housing Act, 42 U.S.C. 3601 *et seq.*, because such an action "sounds basically in tort" and "involves rights and remedies of the sort typically enforced in an action at law." 415 U.S. at 195.[21] The Court noted by contrast (*id.* at 196-197 & n.13), however, that it has consistently been held that there is no right to a jury trial in a Title VII action (*e.g.*, *Johnson* v. *Georgia Highway Express, Inc.*, 417 F.2d at 1125; *Robinson* v. *Lorillard Corp.*, 444 F.2d at 802; see also *Great American Federal Savings & Loan Ass'n* v. *Novotny*, 442 U.S. at 375; *Albemarle Paper Co.* v. *Moody*, 422 U.S. at 442-444 (Rehnquist, J. concurring)) because back pay awards under Title VII are "an equitable remedy" and therefore "contrast[] sharply" with tort type claims and other actions at law that permit recovery of "actual and punitive damages." 415 U.S. at 197. Far from supporting the contention that Title VII back pay constitutes a "tort type" claim to be excluded from income under Section 104(a)(2), this Court's decision in *Curtis* points quite clearly to the opposite conclusion.

There was, accordingly, no tenable justification for the court of appeals to depart from the Service's

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[21] The Court also analogized a violation of the Fair Housing Act to "the common-law duty of innkeepers not to refuse temporary lodging to a traveler without justification." 415 U.S. at 195-196 n.10.

longstanding determination that back-pay awards under statutes such as Title VII are included within the taxpayer's gross income as compensation for services.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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OCTOBER TERM, 1991

UNITED STATES OF AMERICA,
Petitioner,

v.

THERESE A. BURKE, *et al.*,
Respondents.

On Writ of Certiorari to the
United States Court of Appeals
for the Sixth Circuit

BRIEF FOR RESPONDENTS

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QUESTION PRESENTED

Whether discrimination on the basis of sex is a personal injury, so that amounts received in settlement of a claim for sex discrimination in violation of Title VII of the Civil Rights Act of 1964 are "damages received . . . on account of personal injuries" and therefore excludable from gross income for tax purposes under Section 104(a)(2) of the Internal Revenue Code.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-42

UNITED STATES OF AMERICA,
Petitioner,
v.
THERESE A. BURKE, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR RESPONDENTS

This case, which began as a Title VII suit to remedy intentional sex-based discrimination, and proceeded to a settlement in which a $5,000,000 monetary award was distributed to the victims, now presents the question of whether these compensatory settlement proceeds are excluded from income tax as "damages received on account of personal injuries." This question involves the straightforward task of applying the clear language of § 104(a)(2) of the Internal Revenue Code. While the broad and conclusory definition of "income" in 26 U.S.C. § 61 applies to all enhancements of wealth, Congress has determined that some income should nonetheless be excluded from what is considered gross income for tax purposes. In deference to those who have suffered injury, Congress has chosen to exclude "the amount of any damages received (whether by suit or agreement . . .) on account of personal injuries or sickness." 26 U.S.C. § 104(a)(2).

The present case concerns whether this exclusion applies to the portion of a monetary recovery in a Title VII employment discrimination case where the statute allows for recovery as "back pay," and which the legislative history of Title VII and prior decisions of this Court indicate is designed to make a discrimination victim whole for the income lost due to wrongful discrimination. See, e.g., *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 417-19, 421-22 (1975). Thus, despite petitioner's attempt to avoid the language of the exclusion in § 104(a)(2) and instead argue this case as if it involved whether the recovery is an enhancement of wealth and thus within the meaning of "income" in § 61, the resolution of this case turns on whether invidious discrimination is a personal injury for which damages are received. If so, then all amounts recovered to remedy that fundamental wrong to a human being are excluded from taxation under § 104(a)(2).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 104(a)(2) of the Internal Revenue Code states:

> (a) Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc. expenses) for any prior taxable year, gross income does not include—
>
> > (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or periodic payments) an account of personal injuries or sickness;
> >
> > * * * *
>
> Paragraph (2) shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness.

The applicable regulation, 26 C.F.R. § 1.104-1(c) states:

> Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term "damages received (whether by suit or agreement)" means an amount received (other than workman's compensation) through prosecution of a legal suit or action based upon tort or tort-type rights, or through a settlement agreement entered into in lieu of such prosecution.

STATEMENT OF THE CASE

There is more to be said about the sex discrimination suit underlying this case than is provided in petitioner's Statement. The second amended complaint in the original *Hutcheson and OPEIU v. Dean, et al.* (TVA), litigation set forth particular allegations entitled, "The Nature of the Discrimination" to support the claim of intentional discrimination (C.A. App. 28-31).[1] TVA bargained collectively with two groups of unions. One was known as the Trades and Labor Council, consisting of approximately 30,000 employees, of which 97% or more were male (C.A. App. 24). The second group was known as the Salary Policy Employee Panel, consisting of approximately 17,000 employees in five constituent unions, of which the Office and Professional Employees International Union, AFL-CIO, CLC (OPEIU) was one. Within the Panel unions were six salaried groups, where only one, known as Schedule SB, was predominantly female (C.A. App. 25-26).

Prior to 1981, TVA conducted wage and salary surveys within a defined regional geographical vicinity as a foundation for bargaining with its two groups of unions (C.A. 28-29). In 1981, for the first time, TVA unilaterally adopted a local area survey with newly selected employers for the female-dominated SB schedule and two other schedules with significantly smaller numbers of employees. At the same time, TVA continued to use the same regional surveys for its predominantly male groups as it had done in the past (C.A. App. 30). "The selection of these particular employers [in the local survey] was designed and calculated to result in a reduced salary

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[1] References to C.A. App. are to the appendix filed in the court of appeals.

schedule for the [female dominated] SB Schedule, and did result in such a reduced salary schedule . . ." said the district court in the *Hutcheson-OPEIU* case (C.A. App. 30).

The complaint alleged that TVA's conduct constituted intentional discrimination that resulted in disparate treatment of female employees (C.A. App. 31). The complaint also asserted a disparate impact claim. In denying TVA's motion for summary judgment, the district court studied the proof adduced through discovery and then held that the "undisputed factual evidence" led it to find that plaintiffs have "established a *prima facie* case of disparate treatment of women in the 1981 salary schedule changes (C.A. App. 66). Thereafter, TVA was ordered to articulate legitimate business reasons for what it had done. TVA then began serious settlement discussions.

Throughout these discussions, there was never a word between the parties about back pay (C.A. App. 87). TVA agreed to pay $4200 directly to plaintiff Hutcheson without deduction of withholding tax and FICA. When payment of money to the OPEIU was discussed, TVA first proposed to pay the entire $5,000,00 directly to the Union for it to distribute as it would determine (C.A. App. 86). OPEIU said it would be administratively impossible to distribute such an amount to the numerous eligible individuals. Accordingly, the OPEIU asked TVA to make the distribution based on a formula selected by the Union. TVA made it a condition of its doing the distribution that it would deduct withholding taxes and FICA contributions. In order to facilitate the process, the OPEIU agreed to this condition (C.A. App. 88).[2]

[2] A later amendment to the settlement agreement provided that TVA would remit to OPEIU what was undeliverable (C.A.App. 76-78). Under this provision, TVA remitted $114,380.51 to OPEIU. At the time of the making of the record in the district court, OPEIU had made direct distribution to five claimants and did not deduct any withholding or FICA from those proceeds (C.A.App. 91).

The money was ultimately distributed to persons who worked in the SB schedule from June, 1981 to March 10, 1987, taking into account length of service and base rates of pay.

But payments directly to Hutcheson and through OPEIU were only a part of the settlement. In addition to dropping its counterclaim against the Union, TVA signed an intention to return future salary surveys to a regional basis, and an intention to provide a form of salary arbitration in any future contract between TVA and the Salary Panel (C.A. App. 72).[3]

Although there was no explicit provision in the settlement agreement about what would happen to post-settlement salaries in the female-dominated SB schedule, there are sufficient facts from which an undisputed conclusion may be drawn as to what did happen to them. The $5,000,000 paid through OPEIU was in "full and final settlement" of the litigation and TVA was forever released from any liability on account of anything related to or arising out of any matters alleged in the complaint (C.A. App. 74). There was no liability after the March 10, 1987 cut-off date. Strikingly absent from the settlement was any agreement by TVA to put into place any new non-discriminatory salary rates.

Respondents argued in the district court and the court of appeals that the $5,000,000 distribution was not back

[3] The dismissal of the counterclaim relieved OPEIU of an enormous potential liability (C.A.App. 86). The agreement on a new provision on future salary arbitration could not have been sought in the complaint and could not have been obtained in a court judgment. This Court has given wide leeway to parties to resolve Title VII disputes with remedies that could not be obtained by judicial order. *International Association of Fire Fighters v. City of Cleveland*, 478 U.S. 501 (1986). Thus, the fact that the statute at that time only allowed back pay in money terms does not mean that the financial part of any Title VII settlement could only be back pay. See, e.g., *Sweet v. General Tire and Rubber Co.*, 28 F.E.P. Cases 804, 813 (N.D.Ohio, 1982), where the court found that the parties' intent in a settlement agreement was that payment was more in the nature of damages than a back pay calculation.

pay. We may proceed here, no matter what the recovery may be called, on basis that the mony was derived from an action claiming violation of Title VII because of discrimination against women.

The court of appeals below did not undertake any particular classification of the proceeds but framed its question in terms of "whether damages received in a settlement agreement in a Title VII action for sex discrimination are excludable as damages for 'personal injury' under Internal Revenue Code Sec. 104(a)(2)." (Pet. App. 4a).

The court below said that the resolution of the question turned on "whether injuries resulting from sex discrimination in violation of Title VII are 'personal' injuries." (Pet. App. 6a.). It further held that the government's argument must be rejected because it "focuses its analysis on the consequences of a Title VII violation (the payment of back pay for lost wages) rather than the personal nature of the injury (invidious discrimination). (Pet. App. 8a). The court of appeals also met the government's argument that recipients who were not taxed would be better off for tax purposes than those who had not been discriminated against: "a plaintiff who suffers the personal injury of discrimination and loses pay as a consequence will be treated identically to the victim of a physical injury whose damage award which includes lost wages is not taxable despite the fact that those wages would have been taxed had the injury not occurred."

The court below concluded that "Courts have long held that injuries resulting from invidious discrimination, be it on the basis of race, sex, national origin or some other unlawful category, are injuries to the individual rights and dignity of the person. (Citing cases)." (Pet App. 6a). Thus, because the proceeds recovered by respondents were received on account of personal injuries, they were excluded from taxation by the terms of Sec. 104(a)(2).

SUMMARY OF ARGUMENT

Section 104(a)(2) of the Internal Revenue Code excludes from income that otherwise would be subject to taxation "any damages" received "on account of personal injuries." Following this plain language, the inquiry in this case is straightforward: is invidious discrimination on the basis of race, sex, national origin, and religion which is made actionable by Title VII of the Civil Rights Act of 1964 a personal injury for which monetary recovery is damages?

The personal nature of the injury is the first relevant inquiry, rather than whether the personal injury results in economic loss consequences or non-pecuniary consequences. The language of the statute and the applicable regulation applies to *all* amounts recovered for personal injury. By their plain terms, these controlling provisions make no distinction between recoveries for economic loss and recoveries for other losses. Nor does the statute make any distinction between the tax treatment of recoveries for physical injuries and non-physical injuries. Consequently, petitioner's argument, which focuses on the theory that a back pay recovery under Title VII is for economic loss measured by the mount of wage loss, is irrelevant to the proper inquiry under § 104(a)(2). Petitioner's assertions are all directed to the consequences of an injury, rather than to whether the injury is to rights secured to the person.

As this Court found in *Albermarle Paper Co. v. Moody*, 422 U.S. 405 (1975), the purpose of the Title VII back pay recovery is to make victims whole for the injury of discrimination. Thus, a back pay award fits the well-established meaning of the term "damages." Any contrary assertions focused on whether Title VII relief is equitable or not damages ignore the meaning of what damages represent in our legal system and are wrong.

Petitioner fails to come to terms with the recognized compensatory function of Title VII recoveries when it

insists that such recoveries do not restore lost capital. In this regard, a Title VII back pay award is no different in restorative purpose or measurement by the amount of the victim's loss than the lost income portion of any tort recovery for a physical or a non-physical injury. Thus, petitioner's insistence that a back pay award is deferred wages and would have been taxable if the victim had not been wronged completely ignores § 104(a)(2). All tort victims would have paid taxes on their earnings if their earning capacity had not been diminished on account of a wrongful invasion of their rights.

The right to be free from discrimination on the basis of one's race, sex, national origin, or religion is a fundamental personal right. Wrongful deprivations of that right are fundamentally personal injuries. As this Court held in *Goodman v. Lukens Steel Co.*, 482 U.S. 656 (1987), the mere fact that economic interests are one of the interests, or even the main interest, protected by an anti-discrimination statute does not alter the conclusion that the right to be free from discrimination is personal. Since deprivations of Title VII rights are personal injuries, all monetary recoveries from such injury are damages that are excluded from taxation under § 104(a)(2).

The exclusion of Title VII recoveries furthers the purposes of both Title VII and § 104(a)(2). While recently amending Title VII, Congress confirmed that discrimination is as reprehensible as "assaults, batteries, and other intentional injuries to people." And § 104(a)(2) declares that all taxpayers who have suffered such personal injuries should not have to pay tax on their recoveries. While petitioner claims that this may make injured taxpayers better off for tax purposes than non-injured taxpayers, that is essentially a complaint about the terms of § 104(a)(2), and thus a concern for Congress, not this Court. Moreover, the theory about injury victims being better off is misguided. When the recovery is received in a lump sum, this may push the injured taxpayers into a

higher bracket and they may well pay more in taxes than if they had not had their earning capacity diminished due to an invasion of rights. The injury victim is also deprived of interest and other capital and personal investment opportunities during the period of reduced earnings caused by the wrong. And, the mere receipt of monetary compensation does not make a discrimination victim better off than someone who has never suffered the humiliation and indignity of discrimination, because money cannot wholly cure the full extent of the personal destruction.

ARGUMENT

I. THE PROPER INQUIRY FOR EXCLUSION UNDER SECTION 104(A)(2) IS WHETHER THE UNDERLYING CLAIM SEEKS TO REDRESS "PERSONAL INJURIES."

A. The Statute and Regulations Exclude "Any Damages," Defined as Any "Amounts," Received "On Account of Personal Injuries", And Do Not Distinguish Between Recoveries for Economic Loss and for Nonpecuniary Loss.

As this Court has said on countless occasions, in any case of statutory construction, such as this one, "'the starting point is the language of the statute.'" *Dole v. United Steelworkers of America*, 110 S.Ct. 929, 934 (1990) (quoting *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 5 (1985)). Petitioner, however, avoids confronting the plain language of § 104(a)(2) and the implementing regulation, and offers several different theories about why some, but not all, recoveries for the economic loss occasioned by injuries ought to be taxable income. Virtually all of petitioner's arguments and its historical discussion are focused on a provision of the Internal Revenue Code—§ 61—not involved in this case. Without question, awards in tort and tort-like cases are "enhancements of wealth" that could be taxed under the expansive definition of income in § 61, *absent* the statu-

tory exclusion in § 104(a)(2). Thus, it is irrelevant that the recovery in this case fits the definition of "income" in § 61: this case concerns only whether this compensatory recovery is excluded from what would otherwise be income by operation of the plain language of § 104(a)(2). So, we turn first, as we must, to the language of this statute, which supports the position that respondents' Title VII settlement recoveries are damages "on account of personal injury" under § 104(a)(2) and, therefore, are not subject to federal income tax.

Section 104(a)(2) excludes from taxable income "*any* damages received" on account of personal injuries (emphasis added). This language makes no distinction between the damages intended to restore lost wages and the damages attributable to nonpecuniary harm. Similarly, the implementing regulation, 26 C.F.R. § 1.104-1(c), expansively covers all "amounts" received through prosecution of a tort or tort-type claim. This language, too, makes no distinction between amounts received to compensate for economic loss or amounts intended to compensate for the noneconomic consequences of injuries. See, e.g., *Roemer v. Commissioner*, 716 F.2d 693, 697 (9th Cir. 1983); *Threlkeld v. Commissioner*, 87 T.C. 1294, 1299 (1988), *aff'd*, 848 F.2d 81 (6th Cir. 1988).

Throughout its brief, petitioner attempts to divert attention from the inquiry mandated by the language of § 104(a)(2) by characterizing a Title VII back pay recovery as based on wages, and thus in the nature of deferred salary. This assertion amounts to nothing more than pointing out that a back pay recovery compensates for economic loss caused by discrimination. Petitioner's characterization leads to the proposition that the consequences of the injury ought to determine taxability, rather than whether the underlying claim is for a personal injury. This argument totally fails to come to grips with § 104(a)(2). According to the plain language of the statute, both a monetary recovery for economic loss and one for nonpecuniary harm are fully excludable under § 104(a)(2) when the taxpayer suffers a personal injury. See Rev. Rul. 85-97, 1985-2 C.B. 50 (the entire amount received in settlement of a suit for personal injuries, including the portion allocable to the claim for lost wages, is excludable from income under § 104(a)(2)).

Not only is petitioner's "consequences of the injury" test precluded by the language of § 104(a)(2), but it also would make no sense, in light of the multiple impacts of personal injuries and the restorative purposes of tort-type schemes, to read such a test into the statute. Personal injuries, or wrongs that invade rights accorded to persons under the law, frequently have physical and emotional impacts, and lead to both economic loss, such as lost wages and out-of-pocket costs, and nonpecuniary harm, such as pain, humiliation, emotional distress, loss of self-esteem and human dignity. Since tort law and tort-type rights protect economic interests as well as physical and emotional interests, see Prosser & Keeton on Torts 2-3 (5th ed. 1984), compensation for the income lost on account of an injury to one's personal rights is a standard feature of personal injury tort law and of statutes, such as discrimination statutes, that establish tort-type rights.

The court below followed the language of the statute and thus stated and applied the correct inquiry: "determining whether the § 104(a)(2) exclusion applies requires an examination of the nature of the injury to determine whether the injury and claim are personal and tort-like in nature, and not whether the consequences of the injury resulted in an award of compensatory damages or damages for back pay." 929 F.2d at 1121. The Courts of Appeals and the Tax Court are in complete agreement that the applicability of § 104(a)(2) turns on whether the underlying claim for which a monetary payment was received is tort-like and involves a personal injury, and not on whether the consequences of the injury are economic loss or noneconomic loss. See, e.g.,

Bent v. Commissioner, 835 F.2d 67 (3rd Cir. 1987); *Byrne v. Commissioner*, 883 F.2d 211 (3rd Cir. 1989); *Rickel v. Commissioner*, 900 F.2d 655 (3rd Cir. 1990); *Pistillo v. Commissioner*, 912 F.2d 145 (6th Cir. 1990); *Wulf v. City of Wichita*, 883 F.2d 842 (10th Cir. 1989); *Roemer v. Commissioner*, 716 F.2d 693 (9th Cir. 1983); *Redfield v. INA*, 940 F.2d 542 (9th Cir. 1991); *Thompson v. Commissioner*, 866 F.2d 709, 711 (4th Cir. 1989);[4] *Threlkeld v. Commissioner*, 87 T.C. 1294 (1987), aff'd, 848 F.2d 81 (6th Cir. 1988); *Metzger v. Commissioner*, 88 T.C. 834 (1987), *aff'd mem.*, 845 F.2d 1013 (3rd Cir. 1988); *Downey v. Commissioner*, 97 T.C. 150 (1991).

To examine the nature of the injury we look first to whether the employment discrimination made actionable by Title VII is a "personal injury." If it is, then all monetary relief that flows from the injury is excludable from taxable income, regardless of whether the compensatory monetary recovery is part of an equitable package of remedies, whether it only restores wage loss, or whether it also compensates for other losses.

Quite recently, subsequent to the filing of petitioner's brief, the U.S. Court of Appeals for the D.C. Circuit reached the erroneous conclusion that a Title VII back pay recovery was not encompassed by § 104(a)(2) because a monetary amount awarded pursuant to a court's equitable powers was not "damages." *Sparrow v. Commissioner*, No. 90-1151, 1991 U.S. App. LEXIS 27991 (D.C. Cir. Nov. 26, 1991). Thus, the *Sparrow* court refused even to perform the inquiry mandated by

[4] Although *Thompson* noted the proper inquiry and also concluded that sex discrimination is a personal injury and actions to redress sex discrimination are "tort or tort-type actions," 866 F.2d at 712, the court then in fact applied the improper "consequences of the injury" analysis. When it ruled that the Equal Pay Act back-pay award was a recovery for "earned, but unpaid wages" so that the claim was really more in the nature of a contract claim, it allowed the consequences of the injury to control the conclusion about the nature of the claim.

§ 104(a)(2): whether the monetary compensation was received on account of a personal injury. The D.C. Circuit also erroneously failed to consider the regulation, which makes no distinction based on the form of the action. 26 C.F.R. § 1.104-1(c) defines "damages received" as any "*amounts* received through prosecution of a legal suit or action based upon tort or tort-type rights" (emphasis added). A Title VII back pay recovery is such an "amount" received from an action based upon tort or tort-type rights.

The *Sparrow* conclusion that only the monetary amount awarded by a court "at law" could constitute "damages" rested on a fundamental error. The D.C. Circuit stated that because a court at law could only award damages, then only a monetary award "at law" could constitute damages. Slip op. at 6-7. Yet the court failed to recognize that equity courts could award "damages." Although a party seeking only monetary relief had to bring its suit "at law," in a case properly in equity, the chancellor could dispense compensatory damages when necessary to give complete relief, under what is known as the "clean up" doctrine. Indeed, it was so well-recognized that equity courts could award damages when incidental to the equitable relief sought, that as eminent an authority as Mr. Justice Story devoted an entire chapter in his *Commentaries on Equity Jurisprudence* (vol. 2, 13th ed. 1886) to "Compensation and Damages." See *id.* at § 799a, p. 122. See also 1 Pomeroy, A Treatise on Equity Jurisprudence §§ 236-41 (1881). For example, in cases seeking injunctive relief, it was common for an equity court to award damages for the loss, including for torts, up to the time of the injunction. See, e.g., Walsh, A Treatise on Equity 23, 142, 178-180 (1930); *Medtronic, Inc. v. Intermedics, Inc.*, 725 F.2d 440 (7th Cir. 1984); *Langley v. Colonial Leasing Co.*, 707 F.2d 1 (1st Cir. 1983).

The D.C. Circuit in *Sparrow* also ignored the standard definition of "damages," which makes no distinction based

on the form of the action. 25 C.J.S. Damages § 3; 31 C.J.S. Equity § 72. "In legal parlance, the term 'damages' refers to money awarded as reparation for injury resulting from breach of legal duty. Webster's Third New International Dictionary 571 (1991); Black's Law Dictionary 352-352 (5th ed 1979); D. Dobbs, Law of Remedies, § 3.1, p. 135 (1973); W. Hale, Law of Damages 1 (Cooley 2d ed 1912). Thus, the phrase 'money damages' is something of a redundancy, but it is, nonetheless, a common usage and refers to one of the two broad categories of judicial relief in the common-law system. The other, of course, is denominated 'specific relief.' Whereas damages compensate the plaintiff for a loss, specific relief prevents or undoes the loss—for example, by ordering return to the plaintiff of the precise property that has been wrongfully taken, or by enjoining acts that would damage the plaintiff's person or property. See 5A A. Corbin, Contracts § 1141, p. 113 (1964); Dobbs, supra, at 135." Scalia, J., in *Bowen v. Massachusetts*, 487 U.S. 879, at 913-4 (1988) (dissenting).[5]

The term "damages" in § 104(a)(2) should be given its plain, long-established meaning. *Crane v. Commissioner*, 331 U.S. 1, 6 (1947). The statute does not carve out from the general term recoveries for lost pay, nor does it distinguish between damages recovered in an action "at law" or damages recovered "in equity." Thus, the fact that some courts have referred to the back pay compensation provided by ~~Title~~ VII as "equitable" or restitutionary in

[5] 25 C.J.S. Damages § 1 defines "damages" as "the compensation which the law will award for an injury done; a compensation, recompense, or satisfaction in money for a loss or injury sustained; and the most common meaning of the term is compensation for actual injury." Black's Law Dictionary in its 6th edition, 1990, defines "Damages" as "[a] pecuniary compensation or indemnity, which may be recovered in the courts by any person who has suffered loss, detriment, or injury, whether to his person, property, or rights, through the unlawful act or omission of another."

nature[6] is irrelevant to the determination of whether it is embraced within the definition of "damages" in § 104(a)(2). A monetary remedy can be discretionary or incidental to equitable relief, and thus labeled "equitable," but still constitute damages. Restitution in the judicial context is a form of money damages when it is measured by the plaintiff's loss, as a Title VII recovery is, rather than by the defendant's gain. D. Dobbs, Remedies 1-2, 222-223 (1973); *Bowen*, 487 U.S. at 917 n. 2 (Scalia, J., dissenting); Laycock, The Scope and Significance of Restitution, 67 Tex. L. Rev. 1277, 1282-83 (1989). It is the monetary form and compensatory purpose of the recovery that results in the label "damages"; and not whether the "damages are characterized as equitable." *Chauffeurs, Teamsters & Helpers, Local 391 v. Terry*, 110 S.Ct. 1339, 1347-48 (1990).

Nor does the fact that the Title VII recovery is based on pay or called "back pay" preclude application of the label "damages". Pay that would have been received in the absence of the wrong is a classic element of damages. C.J.S. Damages §§ 136-37; D. Dobbs, *supra* at 924-27. The monetary compensation designated as "back pay" in a Title VII case is identical in form and substance to the monetary compensation for lost wages awarded in other tort and employment contexts—compensation widely acknowledged to be "damages." Thus, many courts, including this Court, have referred to Title VII back pay awards with the terminology "damages." See, e.g., *General Telephone Co. v. EEOC*, 446 U.S. 318, 326 (1980); *Johnston v. Harris Cty. Flood Control Dist.*, 869 F.2d 1565-1579-1580 (5th Cir. 1989); *Thompson v. Commissioner*, 866 F.2d 709, 711-12 (4th Cir. 1989); *Metzger v. Commis-*

[6] *Sparrow*, slip op. at 8-9; *Johnson v. Georgia Highway Express, Inc.*, 417 F.2d 1122 (5th Cir. 1969), *Cf. Curtis v. Loether*, 415 U.S. 189, 197 (1974); *Chauffeurs, Teamsters & Helpers, Local 391 v. Terry*, 494 U.S. 558, 110 S.Ct. 1339, 1348-49 (1990) (noting, while carefully avoiding deciding, the characterization by other courts of Title VII back pay as "equitable").

sioner, 88 T.C. 834, 856-58 (1987), *aff'd mem.*, 845 F.2d 1013 (3rd Cir. 1988).

Whether tagged with the label "equitable", as in Title VII, or "legal" as in the Age Discrimination in Employment Act (ADEA), 29 U.S.C. § 626(b), and 42 U.S.C. § 1981, "back pay" is "pecuniary compensation" which can only be awarded to a "person who has suffered loss, detriment, or injury" from the "unlawful act" of invidious discrimination. Therefore, it squarely fits the standard definition of "damages." Black's Law Dictionary 389 (6th ed. 1990). *Cf. United States v. Testan*, 424 U.S. 392, 404 (1976) (describing remedy of Back Pay Act, 5 U.S.C. § 5596, as "money damages"). *But cf. Hubbard v. EPA*, No. 90-5250, 1991 U.S. App. LEXIS 28168 (D.C. Cir. Dec. 3, 1991) (disregarding cases that find back pay compensatory, holds that back pay not within meaning of "money damages" in 5 U.S.C. § 702 because it is in nature of specific performance).

Like the "back pay" sought in *Local No. 391 v. Terry*, 110 S.Ct. at 1348, a duty of fair representation case, the back pay sought in a Title VII case "is not money wrongfully held by [the employer], but wages and benefits [plaintiffs] would have received" but for the wrongful action. *Id.* at 1348. In discrimination contexts such as 42 U.S.C. § 1981 and the ADEA, this monetary award is understood to be "damages." "We conclude that back pay or lost wage determinations are inherently in the nature of legal damages," *Setser v. Novack Inv. Co.*, 638 F.2d 1137, 1140-41 (8th Cir.), *cert. denied*, 454 U.S. 1064; *Lorillard v. Pons*, 434 U.S. 575 (1978); *Rickel v. Commissioner*, 900 F.2d 655 (3rd Cir. 1990); *Pistillo v. Commissioner*, 912 F.2d 145 (6th Cir. 1990); *Redfield v. INA*, 940 F.2d (9th Cir. 1991) (ADEA cases characterizing back pay as damages). See also *Santiago-Negron v. Castro-Davila*, 865 F.2d 431, 441 (1st Cir. 1989) ("back-pay" for unlawful discharge under 42 U.S.C. § 1983 is "legal damages" because in tort actions lost wages are traditionally treated as being an element of

compensatory damages); *Davis v. Passman*, 442 U.S. 228, 245 (1979) (suit for "damages" for sex discrimination brought by congressional employee under Fifth Amendment; only form of "damages" sought was "back pay"; in noting that relief in "damages" for "back pay" would be judicially manageable Court equates the damages sought by Davis with the back pay awarded under Title VII).

To recover for wages lost due to intentional race-based employment discrimination under § 1981 or under Title VII, a plaintiff would have to submit identical proof: that the employment decision was purposeful and based on race, and that the unlawful act caused actual injury in the form of lost wages, and the wage loss was of a certain amount. See, e.g., *Patterson v. McLean Credit Union*, 491 U.S. 164, 186-87 (1989) (adopting proof standards from Title VII for § 1981 claim). The exact same monetary remedy, awarded to compensate for the exact same loss—wage deprivation caused by unlawful employment discrimination—should be regarded as "damages" within the meaning of I.R.C. § 104(a)(2) no matter what employment discrimination statute formed the basis for the recovery. *Cf. Helvering v. Clifford*, 309 U.S. 331, 334 (1940); *Helvering v. Hallock*, 309 U.S. 106, 118 (1940) (rejecting proposition that interpretation of tax laws should turn on classification distinctions of legal history).

Yet the reasoning of the D.C. Circuit in *Sparrow* leads to the anomaly that the same form of remedy is "damages" subject to further analysis under § 104(a)(2) if awarded for employment discrimination under a statute such as § 1981 or the ADEA, but is not "damages" for § 104(a)(2) purposes if awarded for the exact same wrong under Title VII. According to the rationale of *Sparrow*, which denominates some, but not all, compensatory monetary recoveries as "damages," victims of race discrimination in employment who can bring their cases

under both § 1981 and Title VII, but can recover only once for their wage loss, would have to give different tax treatment to the single recovery for the same loss depending on which pleading box it is allocated to. Victims of race discrimination who pursue relief solely under § 1981 could avail themselves of § 104(a)(2), whereas victims of the same unlawful conduct who seek redress only under Title VII could not. And victims of sex-based employment discrimination, who must bring federal claims only under Title VII, would not be able to exclude under § 104(a)(2) the amount received for their lost wages, even though the nature of the wrong, the nature of the injury, and the form and purpose of the compensation are identical to the race discrimination action.

Apparently, even petitioner would not agree with this disparate treatment, since in its brief and in the Petition for a Writ of Certiorari the United States acknowledges that there is no valid basis for distinguishing the tax treatment of back pay under Title VII or under other federal employment discrimination statutes. Pet. Br. at 26 n. 20; Pet. at 17. Moreover, this differential tax treatment of race and sex discrimination victims undermines a principal reason Congress enacted the Civil Rights Act of 1991, S. 1745, 102nd Cong., 1st Sess. (1991). Congress intended to achieve greater remedial parity among victims of sex and race discrimination, not to exacerbate disparities. See H.R. Rep. No. 102-40, Part 2, 102nd Cong., 1st Sess. 24-29 (May 17, 1991); H.R. Rep. No. 102-40, Part I, 102nd Cong., 1st Sess. 15 (Apr. 24, 1991); "[T]he harms women and religious and racial minorities may suffer as a consequence of the various forms of intentional employment discrimination are the same. Where the manifestations of prohibited conduct are the same, and the harms caused are the same, the remedies should be the same as well." This parity can be achieved only if crabbed views of "damages," such as those of the D.C. Circuit, are rejected, and in their

place one uses the common meaning of any monetary recovery to remedy a wrongful act.

B. The Compensation for Either Economic Loss or Nonpecuniary Loss that Flows From Non-Physical Personal Injuries is Excludable Under Section 104(a)(2).

As demonstrated, the plain language of § 104(a)(2) and its implementing regulation apply to all amounts received on account of personal injury, whether the injury is physical or non-physical, and whether the personal injury leads to adverse economic or nonpecuniary consequences. Yet petitioner attempts to equate a back pay recovery under Title VII with wages or lost salary, in order to imply that because the injury causes economic consequences, it cannot be a personal injury. But this is merely another way of arguing that the consequences that flow from an injury should determine the excludability issue. See Ennis & Smolarek, Tax Consequences of Court Awards and Settlement Payments Received in Employment Cases, 6 The Labor Lawyer 395, 400 (1990). It is not whether money or salary has been lost or wrongfully withheld that determines whether an injury is personal or nonpersonal. After all, physical injuries, which are universally acknowledged to be "personal" often lead to lost or diminished salary, and the amounts recovered for lost wages on account of physical injury are plainly excluded from taxable gross income under § 104(a)(2). See Rev. Rul. 85-97, 1985-2 C.B. 50. The determination of whether an injury is personal in nature turns on whether there has been a deprivation or invasion of "rights that an individual is granted by virtue of being a person in the sight of the law." *Threlkeld v. Commissioner*, 87 T.C. at 1308. Accord, *Rickel*, 900 F.2d at 659; *Pistillo*, 912 F.2d at 148.

While petitioner apparently agrees that the Service's rejection in Rev. Rul. 85-97 of the "consequences of the injury" inquiry is correct when physical injuries are

involved, petitioner's position apparently is that when the injury to personal rights is non-physical, one should look at the consequences that flow from the injury to determine whether § 104(a)(2) is applicable. Thus, according to this rationale, if the compensation is for salary lost due to a non-physical injury, then the recovery is not subject to § 104(a)(2), whereas if the monetary recovery is for emotional distress or suffering due to the injury to personal rights, then it is excludable. Pet. Br. at 22-23.[7]

The differential treatment of physical and non-physical injuries conflicts with the plain language of the statute. The statute uses the term "personal injuries." For compensatory recoveries, it makes no distinction between physical personal injuries and nonphysical personal injuries. *Roemer v. Commissioner*, 716 F.2d 693, 697 (9th Cir. 1983). As the Service itself stated in Rev. Rul. 85-98, 1985-2 C.B. 51, "the regulation makes no distinction between physical or emotional injuries" (citing *Seay v. Commissioner*, 58 T.C. 32, 40 (1972), acq., 1972-2 C.B. 3). See also *Miller v. Commissioner*, 93 T.C. 330, 337 (1989) ("Section 104 does not distinguish between physical and nonphysical injuries, and we see no sound reason to construe the statute in such a way as to not afford

[7] While petitioner's brief is somewhat obfuscatory on this point, perhaps deliberately so given the consistency with which courts have rejected the argument, the brief constantly stresses that it is dealing with the inquiry applicable to recoveries involving "non-physical" injuries. *Cf.* Pet. Br. at 21 n.16, where the United States attempts to dismiss Rev. Ruling 85-97 as inapplicable because it dealt with physical injuries. Nothing in the text of that Ruling, however, limits its holding that a recovery to compensate for wage loss is excluded under § 104(a)(2) to physical injuries.

It would not be necessary throughout the brief to stress the non-physical nature of the injury if petitioner's position was that all recoveries compensating for economic loss or nonpecuniary loss for all personal injuries, whether physical or non-physical, were treated the same and thus fully excludable under § 104(a)(2).

the same tax treatment to recoveries for all types of 'personal' injury regardless of consequences.").

The statute draws a distinction between physical and nonphysical injuries only for punitive damages—which back pay under Title VII plainly is not. As a result of an amendment to § 104(a)(2) passed as part of the 1989 Omnibus Budget Reconciliation Act, 103 Stat. 2379 (1989), the statute now provides that the exclusion "does not apply to punitive damages in cases not involving physical injury or sickness." Congress obviously knew how to make the distinction between physical and non-physical injuries. The fact that it chose not to make such a distinction for compensatory recoveries indicates an intent that there should be no such differential treatment.

The legislative history of the 1989 amendment supports this conclusion. The original bill introduced in the House of Representatives would have limited the § 104(a)(2) exclusion for all monetary recoveries to cases involving physical injury or sickness.[8] The Senate bill had no such limitation, and in conference the § 104(a)(2) exemption was circumscribed only for punitive damages in cases involving non-physical injuries. Thus, when analyzing the taxability of compensatory recoveries such as awards for lost wages, it continues to make no difference whether the invasion of personal rights resulted in physical or nonphysical injury.

The Conference Report also acknowledged that "under present law, damages received on account of personal injury are excludable from gross income. In some cases, courts have held that this exclusion is available even though there is no physical injury, for example, in cases involving employment discrimination." H.R. Conf. Rep.

[8] The House Report specifically mentioned that "some courts have held that the exclusion applies to damages in cases involving employment discrimination." H.R. Rep. No. 247, 101st Cong., 1st Sess. 1354-55, *reprinted in* 1990 U.S. Code Cong. & Admin. News 2824-25.

No. 386, 101st Cong., 1st Sess. 622-23, *reprinted in* 1990 U.S. Code Cong. & Admin. News, 3225-26.

The fact that the Conference Report took note of the cases excluding back pay awards in employment discrimination cases and made no statutory change that would overturn these cases indicates that Congress endorsed the judicial conclusion that there should be no distinction between the compensatory recovery in physical injury cases and nonphysical injury cases, and that employment discrimination awards were excludable. See *Rickel v. Commissioner*, 900 F.2d at 664 (citing *Lorillard v. Pons*, 434 U.S. 575, 580 (1978) (Congress presumed to be aware of interpretation of a statute and to adopt that interpretation when it re-enacts statute without change). See also, *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 378-79 n.61 (1982) (Congress' perception of the law, whether or not that understanding is "in some ultimate sense incorrect," is what determines legislative intent).

Petitioner's argument that the tax treatment of economic loss recoveries should be different depending on whether the injury to personal rights is physical or nonphysical has been repeatedly and consistently rejected. See, e.g., *Rickel v. Commissioner*, 900 F.2d 655, 658-59 (3rd Cir. 1990) (discussing numerous cases, and concluding that the back-pay recovery for age discrimination must be excluded under §104(a)(2) just as lost wages recovery would be excluded in a physical injury case). In *Threlkeld v. Commissioner*, 87 T.C. 1294, 1301 (1987), the Tax Court called the inconsistent treatment of physical and nonphysical injuries "analytically irreconcilable." It concluded that the approach for physical injuries, where "the entire award is excluded from income even if all or a part of the recovery is determined with reference to the income lost because of the injury," *id.* at 1300, must be followed for nonphysical injuries as well. The Sixth Circuit affirmed, adopting the reasoning of the

Ninth Circuit in *Roemer v. Commissioner*, 716 F.2d 693, 699 (9th Cir. 1983), that for both physical and nonphysical injuries, "the nonpersonal consequences of a personal injury, such as a loss of future income, are often the most persuasive means of proving the extent of the injury that was suffered, and that the personal nature of an injury should not be defined by its effect." *Threlkeld v. Commissioner*, 848 F.2d 81, 83 (6th Cir. 1988).

In two employment discrimination cases, the Third Circuit held that it is improper to analyze non-physical injuries according to their consequences, thus, explicitly rejecting the same argument now advanced by petitioner, "To the extent that the Commissioner argues that because the settlement was intended to compensate [plaintiff] for economic losses it is therefore compensating her for nonpersonal injuries," the argument should be rejected because the existence of economic loss does not make an otherwise personal injury suddenly nonpersonal. *Byrne v. Commissioner*, 883 F.2d 211, 214 (3rd Cir. 1989); *Bent v. Commissioner*, 835 F.2d 67, 69-70 (3rd Cir. 1987).

The decision below rested solidly on the statutory language, legislative history, and ample judicial precedent when it rejected petitioner's argument that monetary recoveries for non-physical invasions of personal rights must be split, for taxation purposes, into their economic loss components and their nonpecuniary loss components. The monetary recoveries in physical injury cases are not similarly parsed, and thus the approach now urged by the government must be rejected. The fact that a non-physical personal injury, such as an invasion of the personal right to be free from invidious discrimination, may result wholly or in part in economic loss, does not make it a nonpersonal injury. *Rickel*, 900 F.2d at 663.

C. The Fact that Compensation for Economic Loss, Such as Back Pay, is Determined Based on Salary, Does Not Turn it into Compensation for Services Rendered Rather than a Monetary Recovery for Loss on Account of Personal Injury.

Throughout its brief, petitioner refers to the back pay remedy in Title VII as "salary" or "deferred salary" or "earned but unpaid wages" and thus akin to "compensation for services rendered." As we have shown, each of these formulations confuse the fact that economic consequences may flow from a personal injury with the proper determination of whether the injury is to rights secured to the person. *Cf. Davis v. Passman*, 442 U.S. 228 (1979) (existence of and nature of right is prior and separate question from the remedy for violations of right). that would apply only if the recovery is not, in fact, received on account of personal injuries. Thus, they completely beg the question that must be asked under § 104 (a) (2).

Just because the amount of wages lost due to discrimination is a means of measuring the extent of the injury, it is not accurate to characterize the recovery as "for" deferred wages. *Bent v. Commissioner*, 835 F.2d at 70; *Roemer v. Commissioner*, 716 F.2d at 699. There is no relevant analytical difference between the recovery for lost wages in a Title VII or other employment discrimination case, and such recovery in any other tort or tort-like case. In each instance the recoveries are intended to compensate for the economic loss caused by the injury. To insist in either context that because the recovery represents lost, or deferred wages, that it should be taxable completely ignores the language of § 104 (a) (2), which asks "on account of what" were the wages lost.

Petitioner's argument that if the plaintiffs had not been wrongfully deprived of compensation they would have paid taxes on what they would have earned, Pet. Br. at 27, also completely evades the language and intent of

§ 104 (a) (2). All tort victims who suffer lost earnings as a result of their injuries would have been taxed if they had not been wronged and had been able to earn the money all along. See *Rickel v. Commissioner*, 900 F.2d at 658, citing L. Frolik, Federal Tax Aspects of Injury, Damage, and Loss 9 (1987). As the Tax Court noted in *Downey v. Commissioner*, 97 T.C. 150, 177 (1991), "[w]hether the damages paid to the tort victim reflect a substitute for amounts or items otherwise taxable or a substitute for amounts or items to be enjoyed without a tax consequence is irrelevant." These considerations are irrelevant because § 104 (a) (2) requires the exclusion of all amounts received on account of personal injury, regardless of whether some of the amount is for lost wages. If petitioner is concerned that § 104 (a) (2) appears to benefit injured taxpayers over non-injured wage earners—a concern we do not share—its remedy is with Congress, not this Court.

It is also irrelevant to the inquiry under § 104 (a) (2) that, as petitioner asserts, the monetary recovery for economic loss in a Title VII case represents an accession to, or enhancement of wealth. This argument is directed at a question not presented here: does money received as a result of a lawsuit fit the definition of income in § 61 of the Internal Revenue Code, so that it could be taxed (unless exempted from tax by another provision of the Code)? The question here is not whether Title VII recoveries are an enhancement of wealth that *could* be taxed under § 61; the question is whether they are excluded from gross income that otherwise would be subject to tax, by virtue of § 104 (a) (2).

Indeed, throughout its brief, petitioner conflates the inquiry under § 61 with the proper inquiry under the exclusion of § 104 (a) (2). When petitioner asserts that the taxability of recoveries for injuries to personal rights turns on whether the recovery represents a make-whole compensation or a gain or profit, e.g. Pet. Br. at 13-14,

the government is in fact addressing the outmoded inquiry for "income" established by *Eisner v. Macomber*, 252 U.S. 189 (1920). Between the *Eisner* decision in 1920 and the decision in *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955), it was thought that merely restorative make-whole recoveries, such as tort compensation, were outside the definition of "income" because they were not "gain" or "profit." Since *Glenshaw Glass*, however, it is now widely recognized that restorative recoveries are "gain" or "income" for tax purposes, although they are not "gain" for tort purposes because they restore lost capital. Thus, absent the exclusion of § 104(a)(2), all personal injury recoveries could be taxed. See *Roemer v. Commissioner*, *supra*, n.2; *Raytheon Production Corp. v. Commissioner*, 144 F.2d 110 (1st Cir. 1944) (damages award for anti-trust violation is "income" because "income" for tax purposes includes compensation for loss, absent a specific exclusion); recovery can be return of lost capital and still constitute taxable gain.

Virtually all the regulatory interpretations cited by petitioner consequently are irrelevant to the issue to be decided here, because they are simply interpretations of the scope of I.R.C. § 61. They do not mention, discuss, analyze, or interpret the § 104(a)(2) exclusion. See, Rev. Rul. 55-203, 1955-1 C.B. 114; Rev. Rul. 57-55, 1957-1 C.B. 304, Rev. Rul. 72-268, 1972-1 C.B. 313; Rev. Rul. 72-341, 1972-2 C.B. 32; Rev. Rul. 75-64, 1975-1 C.B. 16.[9]

[9] Some of these Revenue Rulings also deal with the definition of "wages" in I.R.C. § 3121(a). They conclude that if something received from an employer is income not otherwise excludable, then it is also "wages." None of them determine that if one receives "damages on account of personal injury" within the meaning of § 104(a)(2), then such a recovery is also "wages." It is our position, and the position of the court below, that if a payment is received "on account of" having suffered an invasion of personal rights, it is not received merely for having performed services. Thus, an amount excluded from "income" also cannot be "wages"

To the extent that these Revenue Rulings could be interpreted as perhaps implicitly dealing with questions of exclusion under § 104(a)(2) when they discuss the definition of "income" in § 61, then their analysis is fatally flawed for ignoring the statute and focusing only on the remedial consequences—replacement of lost wages—and utterly failing to consider whether the loss occurred on account of personal injury. Moreover, Revenue Rulings do not have the force of law, since they merely represent the opinion of an agency lawyer. *Dixon v. U.S.*, 381 U.S. 68 (1965); *Foil v. Commissioner*, 920 F.2d 1196, 1201 (5th Cir. 1990); *Stubbs, Overbeck & Assoc., Inc. v. United States*, 445 F.2d 1142, 1146-47 (5th Cir. 1971); *Virginia Materials Corp. v. Commissioner*, 67 T.C. 372, 377 (1976).

The only Revenue Rulings cited by petitioner that specifically deal with § 104(a)(2) actually undermine its argument and instead support the position taken by the

within the definition of § 3121(a), and thus is not subject to FICA withholdings. "Wages" is a narrower concept than "income." *Rowan Cos., Inc. v. United States*, 452 U.S. 247, 254 (1981). Moreover, because § 3121 requires that the performance of work must be the reason for the payment, the recovery here is excluded from FICA taxes because personal injury is the reason for the recovery in a Title VII case. *Redfield v. INA*, 940 F.2d at 548 (9th Cir. 1991).

Social Security Board v. Nierotko, 327 U.S. 358 (1946), is not to the contrary. The question in *Nierotko* was whether a back pay award for an unfair labor practice discharge under the NLRA would count as "wages" in order to qualify for benefit purposes under the Old Age Survivor's Insurance provisions of the Social Security Act. The Court's conclusion that the back pay did qualify as wages was heavily dependent upon the definitions and structure of the NLRA. By defining discharged workers as still "employees," the NLRA evinced an intent that people in Nierotko's position should continue to receive all benefits of employment. In no way can *Nierotko* be regarded as an interpretation of § 104 (a)(2) or of Title VII, the two statutes involved in the present case. It is the policy of § 104 (a)(2) that awards to compensate for injury are not subject to any taxation.

court of appeals below. Rev. Rul. 85-97, 1985-2 C.B. 50, rules that all recoveries flowing from personal injury are excludable, including the recovery for lost wages. It also rules that just because such a recovery might be designated "wages" for purposes of some other employment taxes, that designation has no bearing on the § 104 (a)(2) exclusion. Rev. Rul. 85-98, 1985-2 C.B. 51, while primarily about punitive damages, an issue not involved here, does note that there is no distinction between the tax treatment of the compensatory recoveries flowing from physical injuries and such recoveries flowing from nonphysical injuries.

Moreover, it is utterly circular to state that because the underlying Title VII case was about wage deficiencies, the settlement recovery was thus back pay paid "on account of" unpaid wages. This reasoning reduces Title VII to a mere back pay statute, rather than the substantive command against the evil of discrimination that it is. The monetary relief obtained here through the settlement was paid "on account of" a claim that there has been a violation of legal rights protected by Title VII. The underlying Title VII case here was not simply a claim for "wages" or "withheld salary"—it was a claim to redress the wrong of employment discrimination. To say that the case was simply about "wage deficiencies" ignores and trivializes the fact that the cause of action was under Title VII, seeking redress for discrimination. It was discrimination that caused the wage deficiencies. The settlement amount represented a recovery for discrimination, not merely a payment of wages.[10]

[10] Indeed, it can strongly be argued, as respondents did in both the district court and the court of appeals, that the settlement recovery in *Hutcheson and OPEIU v. Dean* was not back pay at all. In as much as the characterization of the settlement proceeds may be ascertained from the intent of the parties, the parties never discussed a back pay calculation and never otherwise talked about back pay. TVA paid $4200 directly to Hutcheson without any effort to calculate a back pay amount and without any deduction for withholding or FICA. TVA first offered to pay to the union the gross lump sum of $5,000,000 to be distributed at the union's discretion (Pet. App. 3a). Moreover, the pay that the workers received was not affected by the settlement. It remained the same so long as the existing contract was in effect. These critical factors show that TVA did not consider the money as back pay, and neither did the union. Since the intent of the settlement was that the payment was a general part of a package of remedies for an allegation of discrimination, rather than a wage adjustment, it is especially true in this specific case that it was improper to withhold FICA or to treat the money simply as deferred or adjusted pay for income tax purposes.

Another illogic that permeates petitioner's circular insistence that the recovery was compensation for services performed is that this rationale would have the taxability of a Title VII recovery turn on the form which the discrimination took in any particular case, rather than on whether discrimination is a personal injury with many manifestations. While it might seem superficially accurate to say that a wage discrimination victim who still worked for her employer at the time the suit was resolved is receiving additional compensation for services rendered, this completely overlooks the fact that it was not the performance of services and the failure to pay for them that led to the recovery. It was the injury of discrimination that led to the compensatory recovery. So it is not analytically sound to say that the injured employee was getting "wages," defined as compensation for services rendered.

Nor can a Title VII recovery be characterized as "compensation for services rendered" when, because of discrimination, someone fails to receive a job or promotion, or is discharged, or is so severely harassed that she miss some time at work or be constructively discharged. Invidious discrimination unfortunately manifests itself in many forms, and in each situation it can cause economic loss as well as personal degradation and humiliation. The taxability of Title VII recoveries for the economic loss

should not turn on whether the victim kept on working for the employer throughout the period of discrimination. Nor should it turn on whether the discrimination adversely affected someone's ability to get a job or a better job, to keep a job, or to earn a fair rate of pay in a job.[11]

The various labels petitioner attempts to put on the monetary recovery under Title VII all disregard the crucial analytical fact under § 104(a)(2): the recovery is awarded when the job was lost or not received, or a fair rate of pay was not earned, "on account of," or because, the person was a victim of invidious discrimination. But for the wrongful act of discrimination, the plaintiff would not have suffered an economic loss. The language and structure of § 104(a)(2) require that this Court, to determine whether the recovery is excluded from taxation, must answer the following question: Is invidious discrimination that adversely affects employment opportunities a personal injury? When it called this question the beginning and end of the matter, the court of appeals below properly ascertained the relevant inquiry under § 104(a)(2). And, as we will now demonstrate, the court below reached the proper answer to this determinative question.

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[11] Indeed, petitioner admits that there should be no distinction made among the various forms of discrimination. Pet. Br. at 26 n.20. Despite this admission, petitioner attempts to distinguish the numerous cases contrary to its position as involving discriminatory discharge rather than salary discrimination. Petitioner then recants the emphasis in text on "services performed," and shifts to calling the discrimination recoveries "compensation" that "should have been paid but was not." *Id.* Each of these formulations is equally flawed for focusing solely on the consequences that flow from the injury—money that was not earned—rather than on the determinative question: "on account of what" was the money not earned?

II. TITLE VII INVOLVES A TORT-TYPE RIGHT TO BE FREE FROM INVIDIOUS DISCRIMINATION, AND SUCH DISCRIMINATION IS A PERSONAL INJURY THAT CUTS TO THE HEART OF ONE'S STATUS AS AN EQUAL HUMAN BEING.

A. Claims Under Title VII to Redress Employment Discrimination are Tort-Like Claims Within the Meaning of 26 C.F.R. § 1.104-1(c).

Since the regulation implementing § 104(a)(2), 26 C.F.R. § 1.104-1(c), indicates that the exclusion does not apply to amounts received through prosecution of claims to enforce contracts, but only to tort or "tort-type" claims, *Downey v. Commissioner*, 97 T.C. 150 (1991), it is necessary to analyze whether Title VII claims fit the definition of "tort-type" claims. In *Downey*, the Tax Court adopted the definition of "tort" in Black's Law Dictionary and the definition of "injury" in the Restatement, 2d of Torts to interpret the term: "The term tort has been defined as '[a] legal wrong committed upon the person or property independent of contract' or 'a violation of some duty owing to plaintiff, . . . generally . . . [arising] by operation of law and not by mere agreement of the parties.' Black's Law Dictionary 1489 (6th ed. 1990). See Restatement, Torts 2d, secs. 4 (defining 'duty'), 7(1) (defining 'injury' as 'the invasion of any legally protected interest of another') (1965). The duty, the violation of which gives rise to a tort claim, can arise by statute." 97 T.C. at —; 1991 U.S. Tax Ct. LEXIS 69 at 10.

Title VII squarely fits these standard definitions. Because of our national moral and legal commitment to according human beings equal treatment and equal employment opportunities, Title VII creates a duty that arises by operation of law, independent of contract, to refrain from making employment decisions on the basis of race, sex, national origin, and religion. See *Rickel v. Commissioner*, 900 F.2d at 662; *Pistillo v. Commissioner*,

912 F.2d at 150; *Redfield v. INA*, 940 F.2d at 546; *Downey v. Commissioner*, 97 T.C. 150 (1991) (using same reasoning to find that claims under the ADEA are tort-type claims for personal injury). A breach of the duty established by Title VII gives rise to monetary liability to compensate for the economic loss caused by the injury and for injunctive and other equitable relief. *Cf. Curtis v. Loether*, 415 U.S. 188, 195 (1974) (fair housing provision of Title VIII of the Civil Rights Act "sounds basically in tort—the statute merely defines a new legal duty, and authorizes the courts to compensate a plaintiff for the injury caused by the defendant's wrongful breach"). Petitioner's effort to distinguish *Curtis* on the ground that Title VII provides for different relief than Title VIII is unavailing, because the statutes both establish similar tort-like duties.

This Court has previously used the standards and terminology of tort law to interpret Title VII. In *Price Waterhouse v. Hopkins*, 490 U.S. 228 (1989), the Court relied on the but-for causation standards of tort law to determine the standard for liability. Concurring, Justice O'Connor specifically noted the parallels between Title VII and tort law:

> Like the common law of torts, the statutory employment "tort" created by Title VII has two basic purposes. The first is to deter conduct which has been identified as contrary to public policy and harmful to society as a whole. . . . The second goal of Title VII is "to make persons whole for injuries suffered on account of unlawful employment discrimination." (citing *Albemarle Paper Co. v. Moody*, 422 U.S. at 418)

490 U.S. at 265 (O'Connor, J., concurring). See also *U.S. Postal Service v. Aikens*, 460 U.S. 711, 716-17 (1983) (interprets intent requirement in Title VII with reference to tort of misrepresentation); *Meritor Savings Bank v. Vinson*, 477 U.S. 57 (1986) (looks to common law

agency principles to interpret respondeat superior liability under Title VII).

Claims under Title VII cannot be characterized as contract claims. Rights and remedies provided by a contract are not the source of such claims; the statutory duty not to discriminate and the personal statutory right to be free from such discrimination are what form the basis for claims. In the underlying Title VII case here, the reason the lowering of pay schedules for women was wrongful was not because it conflicted with the contract, but because the rate of pay was calculated based on impermissible considerations of the sex of the worker. The case was brought and settled because plaintiffs asserted that the method of adopting the contract itself violated rights secured to them by Title VII as equal human beings in the eyes of the law.

Petitioner states that the claim is in the nature of a contract claim because the rate of pay an employee might have been contractually entitled to often forms the basis for calculating damages for economic loss under Title VII. While often true, this remedial fact hardly converts a Title VII action into a contract claim. After all, in every tort case where the personal injury results in lost time from work or diminution of the injured person's wage-earning capacity, a contract rate of pay forms the basis for calculating the lost income damages.[12] Under

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[12] In any event, the contractual rate of pay would not have formed the basis for calculating back pay damages in the underlying case here if it had gone to judgment rather than being settled. The plaintiffs were contending that the salary schedules underlying their wage rates were intentionally infected with improper consideration of sex. They were not claiming that they should have been paid the rates contained in some other contract, such as those for workers on other salary schedules. A back pay award in the case could not have been calculated with reference to any contract then in existence. It would have been necessary to attempt to calculate what the salaries might have been in the SB schedules if the contract rate had not been infected with sex dis-

petitioner's rationale, part of every tort claim (or at least tort claims for non-physical injuries) would thus be converted into a contract claim. This attempt to have the kind of loss for which compensation is received dictate the nature of the underlying claim is analytically flawed.

The recent amendments to Title VII in the Civil Rights Act of 1991, S. 1745, 102nd Cong., 1st Sess. further support the conclusion that claims under this statute are tort-like in nature. In cases alleging intentional discrimination, such as the underlying case here, compensatory damages for nonpecuniary harm and punitive damages may now be awarded, and a jury trial is available. Congress expanded the available monetary remedies to better redress the full personal ramifications of the injury caused by discrimination. See H.R. Rep. No. 102-40, Part I at 14-15, 64-65. This amendment now makes the remedies available under Title VII more parallel to those available for race discrimination in employment under 42 U.S.C. § 1981, a claim that, even with its specific protection of the right to contract, is clearly a tort-like claim for personal injury. *Goodman v. Lukens Steel*, 482 U.S. 656 (1987). The extension of monetary remedies to cover more than economic loss does not alter the nature of the underlying claim or injury—it simply adds to the remedies. The fact that Title VII has now been made even more like § 1981 further underscores what has always been the essential similarity of the nature of the two claims—they are tort-like in nature because they create a personal right to be free from invidious discrimination, and they allow victims to seek redress when breaches of the statutory duty cause injury.

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crimination. No such calculation was ever done, and no such calculation formed any part of the settlement. Nor did the settlement result in the contract being changed. No contract formed any part of the remedy in this case.

B. Because Title VII Secures Fundamental Personal Rights, Injuries to those Rights Are Inherently Personal Injuries.

If a wrongful action invades rights "that an individual is granted by virtue of being a person in the sight of the law," that action causes a personal injury. *Threlkeld v. Commissioner*, 87 T.C. at 1308. This means that a right is personal if it inheres in one's status as a human being —such as the right to bodily and emotional security, to privacy, to one's good name, to think and associate freely, and to be treated as an equal without regard to one's sex, race, national origin, religion, or age. Under this formulation, wrongful deprivations of civil rights are classic examples of personal injuries. *Wilson v. Garcia*, 471 U.S. 261 (1985); *Bent v. Commissioner*, 836 F.2d 67 (3rd Cir. 1987); *Wulf v. City of Wichita*, 883 F.2d 842 (10th Cir. 1989).

The right to be free from gender discrimination involved in the present case is well-established as a "personal right." *Davis v. Passman*, 442 U.S. 228, 235 & n.10 (1979). As every court that has faced the question has recognized, discrimination on the basis of race, sex, age, or other personal characteristics is fundamentally a personal injury. *Goodman v. Lukens Steel Co.*, 482 U.S. 656 (1987); *Runyon v. McCrary*, 427 U.S. 160 (1976); *Johnson v. Railway Express Agency, Inc.*, 421 U.S. 454 (1975); *Burke v. United States*, 929 F.2d at 1121-22; *Redfield v. INA*, 940 F.2d 542 (9th Cir. 1991); *Pistillo v. Commissioner*, 912 F.2d 145 (6th Cir. 1990); *Rickel v. Commissioner*, 900 F.2d 655 (3rd Cir. 1990); *Thompson v. Commissioner*, 866 F.2d 709 (4th Cir. 1989); *Downey v. Commissioner*, 97 T.C. 150 (1991); *Metzger v. Commissioner*, 88 T.C. 834 (1987), *aff'd mem.* 845 F.2d 1013 (3rd Cir. 1988).

Seeking to sidestep this wealth of precedent which has found invasions of the right to be free from discrimina-

tion, including discrimination in employment opportunities, to be personal injuries, petitioner argues that no personal injury was involved here because the injury for which plaintiffs sought compensation was an injury to their economic interests. Pet. Br. at 24. Petitioner's argument overlooks the obvious fact that an injury to personal rights can cause adverse economic consequences and still be a personal injury. *Rickel v. Commissioner*, 900 F.2d at 663 ("The nonpersonal consequences of the discrimination, e.g., the loss of wages, does not transform discrimination into a nonpersonal injury.").

An argument virtually identical to the one now advanced by petitioner was emphatically rejected in *Goodman v. Lukens Steel*, 482 U.S. 656 (1987). In that case, the plaintiff sought to equate the § 1981 right to be free from discrimination in contract rights with claims in the nature of contract for statute of limitation purposes. This Court found that the claim was one for personal injuries, and thus the personal injury statute of limitations controlled. The language used to explain the holding is directly applicable here:

> Insofar as [§ 1981] deals with contracts, it declares the personal right to make and enforce contracts, a right . . . that may not be interfered with on racial grounds. The provision asserts, in effect, that competence and capacity to contract shall not depend upon race. It is thus part of a federal law barring racial discrimination, which, as the Court of Appeals said, is a fundamental injury to the individual rights of a person. . . . That § 1981 has far-reaching economic consequences does not change this conclusion, since such impact flows from guaranteeing the personal right to engage in economically significant activity free from racially discriminatory interference.

482 U.S. at 661-62.

Insofar as Title VII deals with the formation, terms and conditions, and termination of employment contracts,

it declares the personal right to have one's employment opportunities free from interference on grounds of one's race, sex, national origin, or religion. The discrimination against the person that the statute prohibits is a fundamental injury to the rights of the person. That Title VII has far-reaching personal and societal economic consequences does not change this conclusion, since such economic impact flows from guaranteeing the personal right to pursue employment opportunities free from the interference of invidious personal discrimination.

Petitioner seeks to dismiss *Goodman* too lightly, when it says that the "decision sheds no light on the proper interpretation of Section 104(a)(2) of the Internal Revenue Code." Pet. Br. at 29. While it is true that *Goodman* was not a tax case, it in fact sheds bright and revealing light on the proper inquiry under § 104(a)(2). The determinative issue under § 104(a)(2) is whether a claim for invidious personal discrimination that affects economic rights is a personal injury. That was the precise question posed in *Goodman*, and this Court concluded that such a claim is indeed one for personal injury.

Petitioner's narrow focus on the economic consequences of discrimination is also flawed because it fails to take into account the panoply of ways in which discrimination adversely affects the person. Although until the recent enactment of the Civil Rights Act of 1991 Congress allowed discrimination victims only compensation for their economic loss, the other personal indignities caused by discrimination, which can now also be compensated, have always existed. As Chief Justice Rehnquist observed, writing for the Court in *Meritor Savings Bank v. Vinson*, 477 U.S. 57 (1986), discrimination "may destroy completely the emotional and psychological stability of minority group workers." Thus, the Court ruled, Title VII's concerns were not limited to instances where there was "tangible loss of an economic character," but also extended to the psychological aspects of the workplace environment and

the entire spectrum of the adverse effects of disparate treatment of women and men. *Id.* at 64.

In the House Report accompanying the Civil Rights Act of 1991, Congress emphatically highlighted the grievous personal injuries that flow from discrimination. "The Committee intends to confirm that the principle of anti-discrimination is as important as the principle that prohibits assaults, batteries, and other intentional injuries to people." H.R. Rep. No. 102-04, Part I, 102nd Cong., 1st Sess. at 15 (1991). The Report went on to elaborate why the personal injury of discrimination is as significant as the other forms of intentional personal injury, including the personal injuries remedied under § 1981:

> [T]he harms women and religious and racial minorities suffer as a consequence of the various types of intentional discrimination are the same: humiliation; loss of dignity; psychological (and sometimes physical) injury; resulting medical expenses; damage to the victim's professional reputation and career; loss of all forms of compensation and other consequential injuries. . . . Gender and religious discrimination are as reprehensible as race discrimination, and should be treated the same for purposes of making victims whole. . . .

Id. at 65. The Report went on to feature testimony by and about employment discrimination victims, describing how the injury they experienced was far more than economic, but also included an overwhelming amount of stress, humiliation, loss of dignity, loss of emotional tranquility, and disruption of personal and family life. These effects ranged across cases involving harassment, termination, salary discrimination, and other disruptions of the terms and conditions of employment. *Id.* Part I at 66-68; Part II at 24-28.

This legislative history underlying the recent amendments to Title VII serves as a powerful reminder of the personal devastation and degradation to human dignity that occurs when an employer discriminates against employees or potential employees on the basis of their most personal attributes—their race, their sex, their age, their ethnicity, their religious beliefs. Thus, all the precedents of this Court, and other courts, that characterize such discrimination as a fundamental personal injury are fully applicable to the interpretation of § 104(a)(2).

C. Excluding Title VII Monetary Recoveries for the Economic Loss Caused by Discrimination from Gross Income for Tax Purposes Furthers both the Purposes of Title VII and § 104(a)(2).

For essentially humanitarian policy reasons, the purpose of § 104(a)(2) is that those who have suffered a personal injury should not be further burdened with taxes. Note, Taxation of Damage Recoveries from Litigation, 40 Cornell L. Q. 345, 346 (1955); Hartnett, Torts and Taxes, 27 N.Y.U. L. Rev. 614, 627 (1952). Courts have expressed this rationale in compensatory terms: "damages paid for personal injuries are excluded from gross income because they make the taxpayer whole for a previous loss of personal rights—because, in fact, they restore a loss of capital." *Starrels v. Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962) (citing *Glenshaw Glass*, where Court observed in a footnote that "personal injury damages are by definition compensatory only," 348 U.S. at 432 n.8).[13] Thus, by definition, if an amount is

[13] It is unclear what, if anything, the *Starrels* court meant to add with the phrase referring to restorations of lost capital. At that time, the economic theory of human capital was not well developed, so the court was probably not referring to the human body as a form of capital. (The leading proponent of human capital theory, Theodore Schultz, began to publish this theory in economics journals in the early 1960's, see, e.g., Schultz, Investment in Human Capital, 51 Am. Econ. Rev. 1 (1961)). Moreover, the tax code has never treated the human body or health or other personal endow-

paid to restore, or compensate for a loss occasioned by personal injury, it is the sort of gain or accession of wealth that, in the judgment of Congress, should not be taxed.

A back pay recovery in a Title VII case squarely fits this rationale because it is intended to compensate, or make whole for the economic injury suffered through discrimination. *Albermarle Paper Co. v. Moody*, 422 U.S. at 418, 421 (citing legislative history of 1972 amendments to Title VII, 118 Cong. Rec. § 7168 (1972)). Despite acknowledging at some points in its brief that these Title VII awards are compensatory (Pet. Br. at 24, 27), at other points petitioner seems to retreat by calling a Title VII recovery one that merely represents an accession to wealth in the form of deferred wages (Pet. Br. at 20, 21). As previously demonstrated, this argument is tautological; in all personal injury cases in which a plaintiff recovers a monetary awards, there is, in economic terms, an accession to or enhancement of wealth.

Petitioner repetitively asserts, without any supportive analysis, that back wages cannot be viewed as compensation for lost capital. But the mere repetitive incantation of this point does not make it so. To the contrary, even a brief analysis of the restorative function of Title VII awards and the effect of discrimination on human capital

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ments as a form of capital with a tax basis, so that in one sense money received as compensation for an injury to these interests is always a realized accession to wealth. See *Roemer v. Commissioner*, 716 F.8d at 696 n.2; Stephen, Taxation and Human Capital, 70 Va. L. Rev. 1357, 1387-88 (1984).

It is most likely that the *Starrels* court simply used the word "capital" as a synonym for "money." Thus, the court was referring to personal injury awards that compensate for a loss of money occasioned by the injury, and was simply reiterating its emphasis on compensation for a loss of personal rights.

In this brief we will address both how Title VII awards fit this compensatory rationale, and also how discrimination impairs human capital and the ability to earn a fair return on one's capital.

makes it clear that a Title VII back pay award is *precisely* compensation for lost capital. A back pay award under Title VII serves the exact same purpose as the lost income damages received in any tort case. In essence it is compensation for income lost due to the wrongful act of discrimination. Income is one of the benefits derived from putting one's human capital to use. When income is lost through injury, the victim has suffered a loss of capital. Petitioner has made no efforts to distinguish the purpose of a Title VII recovery from the obviously excludable lost income recoveries flowing from other tort claims, nor can any such distinction be made. The lost income award in a Title VII case is just as much a restoration of lost capital as the lost income component of the award in any personal injury tort case.[14]

Personal, or human, capital is the sum total of attributes that a person has or acquires that make up her productive capacity of income-earning potential. One's body, health, strength and time are elements of human capital, as are intelligence, skill, education, training. See, e.g., Stephen, Federal Income Taxation and Human Capital, 70 Va. L. Rev. 1357, 1358-62 (1984). Diminutions of one's earning capacity, whether through physical injury, discrimination, or dropping out of the workforce or school, all constitute impairment of human capital. See, e.g., Posner, An Economic Analysis of Sex Discrimination Law, 56 U. Chi. L. Rev. 1311 (1989). It is widely recognized by economists that discrimination permanently reduces human capital because it undermines self-esteem and aspirations, and thus can reduce job

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[14] It is not necessary, as petitioner seems to imply at note 16 of its brief, for an impairment to be permanent or for the injury victim to have been rendered incapable of performing any work. Frequently, injuries will keep persons out of work temporarily, or reduce earning capacity, rather than rob it entirely. A reduction, even for a short time, of one's ability to earn the same return on human capital that one could have earned absent the wrongful conduct, is a loss of capital.

motivation and productivity. See Donohue, Prohibiting Sex Discrimination in the Workplace: An Economic Perspective, 56 U. Chi. L. Rev. 1337, 1348-49, 1353-54 (1989). The low self-esteem and sense of hopelessness about getting ahead that discrimination can engender also distort individual investments in human capital—if someone feels that her sex or race will still be a barrier to advancement or fair remuneration even if she gets additional training, she may forego the effort and expense of the investment in herself. *Id.* at 1357-58.

Discrimination fundamentally impairs human capital because it does not allow workers to advance as far as their capital attributes and investments would otherwise permit. Victims of employment discrimination are denied the opportunity to put their human capital to full use or to have their expenditures of human capital fairly evaluated and compensated, without regard to their race, gender, religion, or ethnicity. In this case the workers in the female-dominated job categories got a lower return on their human capital just because they did "women's work," while the mostly male workers in other job categories had the opportunity to get a fair return on their human capital uninfected by impermissible considerations of gender. The workers who were victimized by the discrimination therefore suffered a loss of capital. If their salary had been set based on their capital attributes rather than on their sex, they would have derived a greater return on their human capital. Consequently, if the case had gone to trial and they had received a back pay award, that award would have restored the fair return on capital of which they were wrongfully deprived.

For these reasons, petitioner is plainly wrong when it asserts that a back pay award represents salary for services rendered rather than a compensatory award designed to restore the capital lost through discrimination. Given their compensatory function, excluding Title VII recoveries from gross income for tax purposes fully comports with the purpose of § 104(a)(2).

Petitioner seeks to avoid this conclusion by arguing that unless their recoveries are taxed, discrimination victims will be better off than those who were not victimized by discrimination and kept working without interruption or diminution in salary. This argument, which was also adopted by the D.C. Circuit in *Sparrow*, has several flaws. First, it completely ignores § 104(a)(2). Second, its accuracy is suspect. Finally, it ignores the inherent adverse effects of discrimination, which are not remedied by recovery for only the economic loss.

Even on the doubtful assumption that injury victims really are better off than those who have not been injured simply because the victim does not have to pay taxes on the recovery, that is the judgment Congress has made by adopting § 104(a)(2). As several courts of appeals have pointed out, excluding recoveries in discrimination cases accords discrimination victims tax treatment *equal* to that of physical injury victims who have suffered lost income. The statute commands that all personal injury victims shall receive the same tax treatment. *Rickel*, 900 F.2d at 664; *Pistillo*, 912 F.2d at 150; *Burke*, 929 F.2d at 1123.

The government's "windfall" argument also overlooks the fact that a taxpayer who has to pay tax on a lump sum recovery in the year the recovery is received may well be worse off for tax purposes than persons who received money in incremental amounts spread out over a period of years. The lump sum recovery may well push the taxpayer into a higher tax bracket, and the taxpayer may well have fewer deductions to set off against the lump sum in the year it is received. In contrast, the taxpayer whose earnings were not diminished by discrimination or other injury may have remained in a lower tax bracket, thus paying less taxes in the long run than the victim who must pay at once the full tax on a lump sum recovery.[15] Moreover, the injury victim

[15] The "better off" argument is especially suspect here. The settlement amount was not based on a back pay calculation, no back

has been deprived of the use of the money for a long period of time, without interest, and thus may have lost investment or personal opportunities.

It is also erroneous to call a discrimination victim "better off" than someone who never suffered discrimination because there are long-lasting effects of discrimination that no amount of money can heal. The indignity, the stress, the anger, and the reduced self-esteem all remain with the wronged person. *Pistillo*, 912 F.2d at 150. As one sex discrimination victim eloquently explained to Congress during hearings on the Civil Rights Act of 1991, "compensatory and punitive damages will not give back to a plaintiff, in many cases, the career that they lost or the ability to rise further in that career. . . . It's a lasting damage. . . . Back pay . . . cannot compensate me for the emotional damage and career damage to [my] life's work." Testimony of Nancy Ezold, quoted at Hearings, *supra*, Part I, at 68-69. To call discrimination victims "better off" simply because, by operation of § 104(a)(2), they pay no taxes on their compensatory recovery, is to trivialize the seriousness and devastation of invidious discrimination. Excluding Title VII recoveries from taxation gives recognition to the full gravity of the harm of discrimination, and comports with Congress' recognition that discrimination is at least as reprehensible as "assaults, batteries, and other intentional injuries to people." *Id.* at 15.

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pay was in fact ever paid, and each person who received a distribution from the settlement proceeds very likely received far less than any actual wage loss that was suffered as a result of discrimination. For example, respondent Burke's gross recovery was $764.94 (petitioner's brief, p. 4) for a period covering almost six years, more exactly 69 months, amounting to $11.09 per month, or approximately 37 cents per day. Similar calculations may be made for respondents Carter and Gibbs.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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OCTOBER TERM, 1991

UNITED STATES OF AMERICA, PETITIONER

v.

THERESE A. BURKE, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

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No. 91-42

UNITED STATES OF AMERICA, PETITIONER

v.

THERESE A. BURKE, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

The issue in this case is whether payments received from an employer in settlement of back wage claims under Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e *et seq.*, are excluded from gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness," 26 U.S.C. 104(a)(2). We urge in our opening brief that: (a) Section 104(a)(2) excludes from income damages received to compensate for a loss of human capital, Br. 9-15; (b) it does not exclude settlement awards for back wages, which are taxed instead in the same manner as wages that are paid when earned, Br. 15-20; and (c) the court of appeals accordingly erred in treating the settlement amounts paid to respondents as excludable, Br. 20-31.

Respondents agree that this case turns on whether a Title VII award is subject to the Section 104(a)(2) exclusion. They put forward, however, an extraordinarily expansive interpretation of the statutory provision. Respondents contend that Section 104(a)(2)'s use of the term "damages" can describe "any monetary recovery to remedy a wrongful act," Resp. Br. 9-19, and its use of the term "personal injury" can describe any "deprivation or invasion of 'rights that an individual is granted by virtue of being a person in the sight of the law.'" Resp. Br. 19-30. Respondents then argue, based on those broad definitions, that a Title VII award "squarely fits" within the Section 104(a)(2) exclusion, because the recipient receives money for an injury to "one's status as an equal human being." Resp. Br. 31-44. Respondents' argument is both far-reaching and far-fetched.

1. We address at the outset respondents' equivocal characterizations of the Title VII settlement award that they received. See Resp. Br. 5-6, 24, 28, 29-30. As we explain in our opening brief, respondents received payments arising from the settlement of a Title VII complaint alleging unlawful wage discrimination. See U.S. Br. 2-4, 15-17. The only monetary relief then available under Title VII, and the only monetary relief sought in the complaint, was "back pay," which a court may award as part of the "equitable relief" authorized by the statute. See 42 U.S.C. 2000e-5(g). See Pet. App. 22a, 32a-33a, 34a; see also discussion at pp. 7-10, *infra*.

A settlement award has the same character for tax purposes as the underlying claim. See, *e.g.*, *Lyeth* v. *Hoey*, 305 U.S. 188, 196 (1938). Thus, respondents' settlement award must be treated as an award of Title VII back pay. U.S. Br. 17. Indeed, pursuant to

the terms of the settlement agreement, the employer deducted income and FICA taxes before paying the settlement sums to respondents. See Pet. App. 24a-25a. Respondents' preference for the use of descriptive terms other than back pay cannot disguise the substance of the settlement—the employer compromised a wage-discrimination suit by giving affected employees additional pay for work that they had performed. See Pet. App. 32a-34a.

2. The question squarely presented, then, is whether a Title VII award for *back wages* is excludable from gross income for purposes of federal taxation as "damages received * * * on account of personal injuries or sickness," 26 U.S.C. 104(a)(2). The intuitive answer is, of course, no. A Title VII back pay award is meant only to provide the recipient with the income she would have been paid in the absence of discrimination and is merely a substitute for wages that, if paid when earned, would have been subject to tax. See *Social Security Board* v. *Nierotko*, 327 U.S. 358, 363-366 (1946) (holding that back pay awarded under the National Labor Relations Act (NLRA) for an unlawful discharge represents "wages" for purposes of the Social Security Act). As we explain in our opening brief, the Internal Revenue Service has long followed that sensible approach in Title VII and analogous contexts, ruling that back pay awards under the NLRA and awards of overtime compensation and unpaid minimum wages under the Fair Labor Standards Act are included in gross income. See U.S. Br. 18-19.

Respondents nonetheless argue that a "back pay" award should not be taxed as if it were "pay." They reach that counter-intuitive result through supposed reliance on the "plain language" of Section 104(a)(2).

Resp. Br. 9. Respondents analyze three central words found in Section 104(a)(2)—"damages," "personal," and "injuries"—by looking at each one in isolation and giving it the broadest definition that the word could carry by itself. They then combine those definitions without regard to the more specific meaning that the words convey by relation to one another. Under their interpretation, Section 104(a)(2)'s exclusion for "damages received * * * on account of personal injuries" would include "any monetary recovery to remedy a wrongful act" that has resulted in "a deprivation or invasion of rights that an individual is granted by virtue of being a person in the sight of the law." Resp. Br. 19.

Respondents' composite approach is misconceived. Respondents ignore the settled rule that exclusions from income "should be construed with restraint" in light of Congress's policy "to tax income comprehensively." *Commissioner* v. *Jacobson*, 336 U.S. 28, 49 (1949). Cf. *United States* v. *Wells Fargo Bank*, 485 U.S. 351, 354-355 (1988). More fundamentally, their process of dissecting Section 104(a)(2)'s language one word at a time and then combining the products creates a predictably frankensteinian result that would wreak havoc on settled law. As this Court recently reiterated, words "are not pebbles in alien juxtaposition." *King* v. *St. Vincent's Hospital*, No. 90-889 (Dec. 16, 1991), slip op. 6, quoting *NLRB* v. *Federbush Co.*, 121 F.2d 954, 957 (2d Cir. 1941) (L. Hand, J.). Instead, "the meaning of statutory language, plain or not, depends on context." *King*, slip op. 6. Close attention to the context of statutory terms frequently reveals a "more limited purpose" than those terms, construed in isolation, might support. See *Shell Oil Co.* v. *Iowa Dep't of Revenue*, 488 U.S. 19, 24-26 (1988).

The context here is decisive. As we explain in our opening brief, Section 61(a) of the Internal Revenue Code requires a taxpayer to include all accessions to wealth as gross income, unless the accession is subject to a specific exclusion. See U.S. Br. 9-10. Section 104(a)(2) provides a limited exclusion for "damages received * * * on account of personal injuries or sickness." As this Court recognized in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955), that exclusion is provided because compensatory damages for personal injuries function as "a restoration of capital for taxation purposes." *Id.* at 432 n.8. The lower courts have long emphasized that principle in explaining Section 104(a)(2). As the Ninth Circuit stated 30 years ago:

> Damages paid for personal injuries are excluded from gross income because they make the taxpayer whole from a previous loss of personal rights—because, in effect, *they restore a loss to capital.*

Starrels v. *Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962) (emphasis added); accord *Commissioner* v. *Miller*, 914 F.2d 586, 590 (4th Cir. 1990). See U.S. Br. 9-15.[1]

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[1] Respondents assert that "[i]t is unclear what, if anything, the *Starrels* court meant to add with the phrase referring to restorations of lost capital," because "[a]t that time, the economic theory of human capital was not well developed." Resp. Br. 39 n.13. This argument is devoid of merit. The Service articulated the concept of human capital more than 70 years ago. See S. 1384, 2 C.B. 71, 72 (1920) (citing 31 Op. Att'y Gen. 304 (1918)). This Court's 1955 decision in *Glenshaw Glass* noted the Service's "long history of departmental rulings" on the subject. 348 U.S. at 432 n.8. And as respondents concede, a "leading proponent of human capital theory" had published an article on the concept of human capital prior to the *Starrels* decision. See Schultz, *Investment in Human Capital*, 51 Am. Econ. Rev. 1 (1961). See Resp. Br. 39 n.13.

The basic rationale for the Section 104(a)(2) exclusion—that the taxpayer should not be taxed on amounts received to restore lost human capital—is absent in the case of Title VII back-pay awards. A Title VII back-pay award, unlike an award of damages for personal injury, does not restore a loss of capital; instead, it provides the taxpayer with wages that, if paid when earned, would have been subject to tax. See *Thompson* v. *Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989); *Watkins* v. *United States*, 223 Ct. Cl. 731 (1980); *Johnson* v. *Georgia Highway Express, Inc.*, 417 F.2d 1122, 1125 (5th Cir. 1969); *Hodge* v. *Commissioner*, 64 T.C. 616, 619 (1975); Rev. Rul. 72-341, 1972-2 C.B. 32. There is no reason, under Section 104(a) or otherwise, why a delay in the payment of wages should result in their exclusion from income.

Respondents have no satisfactory response to this fundamental distinction between restoration of lost capital and delayed payment of wages. At first, they simply discount the importance of that difference. Respondents contend that the distinction "amounts to nothing more than pointing out that a back pay recovery compensates for economic loss caused by discrimination" (Resp. Br. 10) and that there is no basis for distinguishing "economic harm" from "nonpecuniary harm" (Resp. Br. 10, 11, 12, 37). The distinction that we draw, however, is not between economic and non-economic loss, but rather between compensatory damages that, in effect, "restore a loss to capital," *Starrels*, 304 F.2d at 576, and Title VII back pay awards, which are simply delayed payment of wages earned. See U.S. Br. 13-15.[2]

[2] Respondents also express confusion over the Service's treatment of "physical" and "non-physical" personal injuries. Resp. Br. 20 n.7. The Service's position, however, is clearly stated in our opening brief. U.S. Br. 14 n.13. As we explain there, the Service originally took the position that Section 104(a)(2) excluded only compensation for physical injuries. In 1983, the Ninth Circuit concluded that nonphysical injuries, such as injury to one's reputation, are encompassed within the Section 104(a)(2) exclusion. See *Roemer* v. *Commissioner*, 716 F.2d 693, 697 (1983). The Service no longer contends that the personal injury must be "physical." Nevertheless, the recovery for the injury—whether physical or nonphysical—must be to compensate for a loss of human capital. See *Commissioner* v. *Miller*, *supra*.

At a later point in their brief, respondents argue that "a Title VII back pay award is *precisely* compensation for lost capital." Resp. Br. 41 (emphasis in original). Respondents erroneously equate the delayed payment of wages with the restoration of capability to produce income. Title VII allows an equitable award of back pay to give the victim of wage discrimination her deserved wages for services performed; that remedy does not take into account or seek to restore any asserted loss in ability to produce income. The recipient of a personal injury award, by contrast, receives an award specifically designed to compensate him for his loss in income producing capability. The mere fact that his loss in human capital may be *measured* by the net present value of his lost future income does not mean, as respondents suggest (Resp. Br. 41), that back pay is capital. See U.S. Br. 21 n.16.

3. The natural and ordinary meaning of the statutory terms "damages received" and "on account of personal injuries or sickness" preclude respondents' proposed interpretation of 26 U.S.C. 104(a)(2).

a. As we have observed, respondents argue (Br. 9-19) that Section 104(a)(2)'s use of the term "any damages received" can be equated with "any monetary recovery to remedy a wrongful act" (Br. 19).

This Court, however, has long recognized that a judicial award of compensatory damages cannot be automatically equated with an equitable remedy, such as restitution or back pay, that is provided as an incident to injunctive relief. See *Local No. 391* v. *Terry*, 494 U.S. 558, 571-572 (1990); *Curtis* v. *Loether*, 415 U.S. 189, 196-197 (1974). Indeed, as respondents recognize (Resp. Br. 12-13), a unanimous panel of the D.C. Circuit recently concluded that Section 104(a)(2)'s use of the term "damages" provides a sufficient basis, by itself, to conclude that the Section 104(a)(2) exclusion does not apply to Title VII back pay awards. *Sparrow* v. *Commissioner*, No. 90-1151 (D.C. Cir. Nov. 26, 1991) (*reprinted in* App., *infra*, 1a-17a).

When Congress first enacted Section 104(a)(2) in 1918, it was well established that damages are provided in actions at law "'as compensation for loss sustained.'" *The Steel Trader*, 275 U.S. 388, 391 (1928) (quoting 1 *Sedgwick's Damages* 24 (9th ed. 1912)). It was also well established "that damages cannot be given in a court of equity" except "under peculiar circumstances." *Veazie* v. *Williams*, 49 U.S. (8 How.) 134, 160 (1850) (citing, *inter alia*, J. Story, *Commentaries on Equity Jurisprudence* §§ 711, 779, 788, 794 (4th ed. 1846)). The court of appeals in *Sparrow* concluded that Congress understood and observed that distinction when it formulated the Internal Revenue Code's Section 104(a)(2) exclusion and Title VII's remedies. See App., *infra*, 6a-7a.

Congress specifically provided in Section 104(a)(2) that taxpayers may exclude certain types of "damages" from gross income, 26 U.S.C. 104(a)(2), and it specifically provided in Title VII that successful plaintiffs are entitled to "equitable relief" including

"back pay"—but not damages, 42 U.S.C. 2000e-5(g). The plain implication is that a taxpayer may not exclude a Title VII back pay award because back pay is not the equivalent of a "legal" remedy of damages, but rather is an adjunct to injunctive relief. See App., *infra*, 7a-10a. That implication finds confirmation in Congress's recent amendments to Title VII, which authorize compensatory and punitive damages in certain prescribed circumstances, but retain the distinction between damages and back pay. See Civil Rights Act of 1991, Pub. L. No. 102-166, § 102, 105 Stat. 1071, 1072.[3]

Respondents contend that the D.C. Circuit's decision "rested on a fundamental error" because it "failed to recognize that equity courts could, in some circumstances, award 'damages.'" Resp. Br. 13. But even if equity courts could award "damages" in "peculiar circumstances," *Veazie*, 49 U.S. (8 How.) at 160, "back pay" would not constitute "damages" under the established meaning of that term. As this Court explained in *Veazie*, an equity court could provide monetary relief as an incident to an equitable remedy, such as by ordering an auctioneer who employed sham bids to give the purchaser a partial re-

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[3] Section 102 of that Act provides that a Title VII plaintiff who brings a suit based on unlawful intentional discrimination and cannot recover damages under 42 U.S.C. 1981 "may recover compensatory and punitive damages as allowed in subsection (b) *in addition to* any relief authorized by [42 U.S.C. 2000e-5(g)]." 105 Stat. 1072 (emphasis added). Section 102 further states:

> Compensatory damages awarded under this section shall not include backpay, interest on backpay, or any other type of relief authorized under [42 U.S.C. 2000e-5(g)].

105 Stat. 1073. Thus, Congress has emphatically reaffirmed its distinction between Title VII back pay and "damages."

fund to "restore what was obtained by the puffing and fraud." 49 U.S. (8 How.) at 160. But that remedy simply carries out the "established rule" that "the injured party is placed in the same situation, and the other party is compelled to do the same acts, as if all had been transacted with the utmost good faith." *Ibid.* The monetary relief "is not giving damages either *eo nomine* or in substance." *Ibid.* The same is true with respect to a Title VII back pay award, which places the employee "in the same position as if he had not been discriminated against, no more and no less." *Sparrow*, App., *infra*, 16a.

Respondents further contend that the "standard definition of 'damages' * * * makes no distinction based on the form of the action" (Resp. Br. 13-14) and that courts have referred to back pay awards with the terminology of "damages" (Resp. Br. 15-17). The first contention is inaccurate, for the reasons we have just explained. The second is entitled to little weight; the colloquial use of the term "damages" to describe Title VII back pay awards does not reflect a considered conclusion that "back pay" is the equivalent of "damages" for purposes of the Section 104(a)(2) exclusion. In any event, those contentions are beside the point. The critical question here is what Congress intended. Respondents' equation of the term "damages" with "any monetary recovery to remedy a wrongful act" cannot be reconciled with Congress's carefully drawn distinction between "damages" and "back pay." See *Sparrow*, App., *infra*.[4]

[4] Respondents also argue (Resp. Br. 19-24) that Section 104(a)(2) does not distinguish between "economic" and "non-pecuniary loss." As we explain above, however, the relevant distinction is between compensation for a loss in human capital and a delayed payment of wages that would have been subject to taxation if paid when earned. Respondents' differentiation between "economic" and "non-economic" losses, like the distinction between "physical" and "non-physical" injuries, see note 2, *supra*, is not relevant to the question at hand. Respondents also contend (Resp. Br. 24-30) that "[t]he fact that compensation for economic loss, such as back pay, is determined based on salary, does not turn it into compensation for services rendered." A "back pay award" by definition, however, cannot be anything other than "compensation for services."

b. Even if a Title VII back pay award could in some sense be equated with compensatory "damages," respondents would also be required to show that they received the award "on account of personal injuries or sickness." Respondents argue (Resp. Br. 31-44) that their back pay award fits that description because Title VII confers a "tort-type right" of freedom from employment discrimination and because discrimination "cuts to the heart of one's status as an equal human being." The first argument is inaccurate while the second argument is insufficient to establish a "personal injury" within the normal meaning of that term.

Although respondents assert otherwise, there can be little doubt about the *ordinary* meaning of the term "personal injury":

> Under the American decisional law, the phrase "personal injury" denotes primarily an injury to the body of a person.

1 S. Speiser, C. Krause & A. Gans, *The American Law of Torts* § 1.1, at 6 (1983) (citations omitted); accord 74 Am. Jur. 2d *Torts* § 2 (1974). The Service has reasonably concluded that Congress employed the term "personal injuries" according to its primary usage. That conclusion finds support in Section

104(a)(2)'s reference in the same phrase to "sickness," which also affects "the body of a person." Although the term "personal injury" is sometimes used to describe a broader group of "non-physical" injuries that are actionable as torts (such as defamation), there is no basis for respondents' contention that the term personal injury includes any injury that is "tort-type" or affects one's "status as a human being."

Respondents mistakenly argue (Resp. Br. 31-34) that the Service's regulations indicate that all "tort-type" injuries should be treated as "personal injuries." They rely on 26 C.F.R. 1.104-1(c), which states in pertinent part:

> Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

That regulation, however, reinforces the government's position. The regulation does not purport to define the phrase "personal injuries." Rather, it defines the term "damages received," and indicates, as we have urged, that the term applies to compensatory damages awarded through a legal action in tort—*i.e.*, money received through an action at law as "compensation for loss sustained." See p. 8, *supra*. The Service has consistently adhered to the position that a Title VII back pay award is not the equivalent of an amount received through prosecution of "tort type rights," see Rev. Rul. 72-341, 1972-2 C.B. 32, and its

interpretation of its regulation is entitled to deference. See U.S. Br. 23-24.

Respondents next argue (Resp. Br. 35-39) that "[b]ecause Title VII secures fundamental personal rights, injuries to those rights are inherently personal injuries." That argument, however, is nothing more than a play on words. The inquiry whether a right is personal in the sense that an individual can enforce it (see Resp. Br. 35, citing *Davis* v. *Passman*, 442 U.S. 228, 235 & n.10 (1979)) has nothing to do with the question whether the remedy is "on account of personal injuries or sickness," 26 U.S.C. 104(a)(2). Respondents' position, coupled with their further assertion that "a right is personal if it inheres in one's status as a human being" (Resp. Br. 35) would lead to absurd results. Under their test, Section 104(a)(2) would exclude every payment of money made in response to an individual's claim of legal entitlement. Indeed, the broad sweep of respondents' test aptly illustrates how far one must go to equate the equitable remedy of back pay with "damages received * * * on account of personal injury or sickness."

4. Finally, respondents contend (Resp. Br. 39-44) that treating a Title VII back pay award as "damages received * * * on account of personal injuries or sickness" would further "both the purposes of Title VII and § 104(a)(2)." At bottom, however, respondents simply assert that victims of discrimination should be entitled to special tax treatment because "there are long-lasting effects of discrimination that no amount of money can heal" and special tax treatment would give "recognition to the full gravity of the harm of discrimination." Resp. Br. 44. The duty of the courts, however, is to apply the Internal Revenue Code as written. The Code does not contain a

special exclusion for Title VII back pay awards, and the Section 104(a)(2) exclusion should not be contorted to achieve that result.

It is respectfully submitted, for the foregoing reasons and the reasons stated in our opening brief, that the judgment of the court of appeals should be reversed.

KENNETH W. STARR
Solicitor General

JANUARY 1992

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued September 30, 1991
Decided November 26, 1991

No. 90-1151

CLEVELAND BUCHANAN SPARROW, SR., APPELLANT

v.

COMMISSIONER OF INTERNAL REVENUE, APPELLEE

Appeal from the United States Tax Court

(Tax Court No. 10073-87)

Before MIKVA, *Chief Judge*, SENTELLE and HENDERSON, *Circuit Judges*.

Opinion for the court filed by *Circuit Judge* HENDERSON.

KAREN LECRAFT HENDERSON, *Circuit Judge*: The issue in this appeal is whether back pay awarded in settlement of a racial discrimination claim filed under Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000e-1 et seq. (1988), is excludable from a taxpayer's income as damages received on account of a personal injury under section 104(a)(2) of the Internal Revenue Code. The Tax Court held that such an award is not. *Sparrow v. Commissioner*, 57 T.C.M. (CCH) 816 (1989). We affirm.

I.

This case was tried on stipulated facts below. The appellant, Cleveland B. Sparrow, Sr., was employed as a GS-9 computer specialist with the Department of the Navy for a period before February 14, 1977. On that date, Sparrow resigned his position after receiving a notice of removal and filed a complaint under Title VII [1] alleging, inter alia, that he had been the victim of racial discrimination. The Navy rejected Sparrow's complaint. Sparrow then sought review by the Equal Employment Opportunity Commission (EEOC). On January 31, 1980, the EEOC held that the Navy had violated its regulations in terminating Sparrow and ordered it to reinstate him pending its investigation of Sparrow's alleged unlawful discharge and other complaints. Although the Navy did begin an investigation, it did not reinstate Sparrow.

Thereafter, Sparrow sought an injunction enforcing the EEOC's order in the district court. The district court denied Sparrow's request as moot because the Navy had begun to investigate but its decision did not address the Navy's failure to reinstate Sparrow.

Shortly after the Navy completed its investigation, Sparrow agreed to settle his complaint. Under the settlement agreement, Sparrow withdrew his request for a hearing on the complaint and also agreed not to initiate any future action or proceeding alleging racial discrimination or reprisal arising out of his em-

[1] Under Title VII, a federal employee alleging that he has been the victim of racial discrimination must file his complaint with the agency he is employed by. Next, on receipt of the employer agency's determination, the employee can either seek review by the Equal Employment Opportunity Commission or file suit in federal district court. Commission decisions may be challenged in the district court. *Brown v. GSA*, 425 U.S. 820, 832 (1976).

ployment with the Navy. The settlement agreement covered Sparrow's claims "in law or in equity, including, but not limited to, any and all claims under the Back Pay Act of 1966 [2] . . . and Title VII of the Civil Rights Act of 1964 . . . or the provisions of the United States Constitution." 57 T.C.M. (CCH) at 817.

In return, the Navy agreed, among other things, to pay Sparrow the sum of $92,300. Of this amount, $69,284 was paid on Sparow's claim for reinstatement for the period from January 31, 1980, through October 27, 1982, when the Navy completed its investigation. The remaining $23,016 [3] was allocated to the settlement of Sparrow's remaining claims (and was expressly conditioned on Sparrow's faithful performance of his obligations under the agreement).

The Navy then paid Sparrow $71,202 in 1982, $15,344 in 1983 and $5,754 in 1984. Sparrow did not report any of these payments as income on his tax returns for the years 1982 through 1984. The Commissioner of Internal Revenue (Commissioner) issued a notice of deficiency determining that Sparrow had under-reported his income in the years 1982 through 1984 and assessed additional taxes and penalties.

Sparrow then filed a petition in the United States Tax Court arguing that the settlement payments were

[2] The Back Pay Act entitles a federal employee, who has been "found by appropriate authority under applicable law, rule, [or] regulation . . . to have been affected by an unjustified or unwarranted personnel action" resulting in the loss or reduction of pay, to recover back pay and attorney's fees. 5 U.S.C. § 5596(b)(1). The Back Pay Act does not itself give rise to an independent claim and therefore has no effect on our decision.

[3] This amount was actually paid in twelve monthly installments. 57 T.C.M. (CCH) at 818.

excludable from his gross income under section 104(a)(2) of the Internal Revenue Code, 26 U.S.C. § 104(a)(2), which provides that "gross income does not include . . . the amount of any damages received . . . on account of personal injuries." Specifically, Sparrow argued that racial discrimination was a personal injury and that the payments he received in settlement of his claim of racial discrimination were therefore non-taxable damages.

The Tax Court did not agree. It first analyzed the nature of the payments Sparrow received under the settlement agreement, finding that $69,284 paid in settlement of Sparrow's claim for reinstatement for the period from January 31, 1980, through October 27, 1982, was compensation for the salary Sparrow "would have received had the Navy Department complied with the EEO Commission's reinstatement order." 57 T.C.M. at 819. Accordingly, the Tax Court held this amount of the settlement was back pay which was taxable as income. *Id.*

The Tax Court then turned to the remaining $23,016 of the settlement agreement. While it noted that "the character" of the payments "was not clearly described in the settlement agreement," it concluded that the payments were "intended to be compensation in lieu of salary payments." *Id.* In reaching this conclusion, the Tax Court first found that the settlement agreement had provided for Sparrow's retroactive promotion from GS-9 to GS-11 effective February 14, 1976, one year to the day before Sparrow resigned. It then concluded that a portion of the $23,016 was attributable to the pay differential between the GS-11 salary he should have received and the GS-9 salary he actually received. While the record does not indicate the precise amount, the Tax Court inferred that the portion of the $23,016 not

attributable to the GS-11/GS-9 pay differential "represented compensation [Sparrow] would have earned had he not been wrongfully discharged as found by the EEO Commission and remained on the payroll for a period either prior to January 31, 1980, or after October 27, 1982." *Id.* The Tax Court also noted that the Navy had described the payments as "Nonemployee Compensation" on the 1099 Forms it filed with the Internal Revenue Service. The Tax Court viewed this as evidence that the Navy "intended to make compensation rather than damage payments."[4] *Id.* Finally, after reviewing the language and legislative history of Title VII, the Tax Court concluded that, because Title VII authorizes only equitable remedies, including back pay, the payments received by Sparrow were not damages excludable from income under section 104(a)(2).

II.

Section 61 of the Internal Revenue Code defines gross income as "all income from whatever source derived." I.R.C. § 61(a), 26 U.S.C. § 61(a). The courts have consistently recognized that, in enacting this section, Congress intended to exercise "the full measure of its taxing power." *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955) (quotations omitted). Thus, it has long been recognized that

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[4] Neither Sparrow nor the amicus curiae, a class of 101 female federal employees who received back pay resulting from a sex discrimination claim against the U.S. Printing Office, challenges the Tax Court's characterization of the payments as back pay or compensation in lieu of salary payments. Accordingly, we have no occasion to review the Tax Court's findings regarding the nature of the payments Sparrow received.

section 61 states a rule of inclusion. *Id.* at 430. In other words, unless another portion of the Internal Revenue Code specifically excludes an accession to wealth from taxation, a taxpayer must include it in his income.

A.

We deal here with one of the exclusions and its applicability to Sparrow's back pay award. Specifically, we are required to construe section 104(a)(2) which provides in relevant part that "gross income does not include . . . the amount of any damages received (whether by suit or agreement and whether as lump sums or in periodic payments) on account of personal injuries or sickness." There are two elements to this exclusion: (1) the amount received must be damages and (2) the amount received as damages must result from a personal injury or sickness. Accordingly, for Sparrow to prevail, he must show both that he received damages and that they were received as compensation for a personal injury.

The predecessor of section 104(a)(2) was originally enacted as section 213(b)(6) of the Revenue Act of 1918, ch. 18, 40 Stat. 1066. This statute expressly exempted from income "the amount of any *damages* received whether by suit or agreement on account of such [personal] injuries or sickness." *Id.* (emphasis added). But neither the Revenue Act of 1918 nor its legislative history defined the meaning of damages. *See* 40 Stat. 1066, §§ 1, 200; H.R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1918). We do know that, at that time, damages were a remedy at law. *See, e.g., Rice & Adams Corp. v. Lathrop*, 278 U.S. 509, 513 (1928) ("No ground for equitable jurisdiction properly could be alleged, for, plainly, none existed, and the bill was merely for an accounting of

profits and damages, the remedy at law which was complete.") (discussing *Root v. Railway Co.*, 105 U.S. 189 (1882)); *United States v. Oregon Lumber Co.*, 260 U.S. 290, 293 (1922) ("plaintiff in error brought an action at law . . . to recover damages"); *Friederichsen v. Renard*, 247 U.S. 207, 208 (1918) (plaintiff was not entitled to equitable relief but had remedy at law for damages); *Archer v. Greenville Sand & Gravel Co.*, 233 U.S. 60, 64-66 (1914) (reversing dismissal of bill in equity because "bill show[ed] a continuing trespass of such a nature and of such character of injury that remedies at law by actions for damages would be inadequate"); *Javierre v. Central Altagracia*, 217 U.S. 502, 508 (1910) (reversing grant of injunction because "a suit for damages would have given adequate relief, and therefore the appellee should have been confined to its remedy at law"). Damages remain today a remedy at law. *See, e.g., Curtis v. Loether*, 415 U.S. 189 (1974). Furthermore, a plaintiff seeking damages had then and retains today the right to a jury trial under the seventh amendment. *See, e.g., Curtis*, 415 U.S. at 195-198; *Ross v. Bernhard*, 396 U.S. 531, 534 (1970); *Capital Traction Co. v. Hof.*, 174 U.S. 1, 13 (1899); *Whitehead v. Shattuck*, 138 U.S. 146, 151 (1891).

We think these authorities make it clear that the term "damages" as used in section 104(a)(2) embodies a monetary amount originally awarded at law, not in equity. We conclude that a taxpayer may exclude an award obtained through the prosecution or settlement of a suit only if he first shows that the amount received constitutes damages as that term has been traditionally defined, that is, an award of money

recoverable in an action at law.[5] We next consider whether a Title VII back pay award constitutes an award of damages under section 104(a)(2).

B.

The starting point for our analysis of whether back pay awarded under Title VII constitutes damages is the language of section 2000e-5(g) of that Title, 42 U.S.C. § 2000e-5(g). Section 2000e-5(g), which prescribes the remedies available when an employer has engaged in discrimination cognizable under section 2000e-2, provides that:

> the court may enjoin the respondent from engaging in such unlawful employment practice, and order such affirmative action as may be appropriate, which may include, but is not limited to, reinstatement or hiring of employees with or without back pay . . . *or any other equitable relief* as the court deems appropriate.

42 U.S.C. § 2000e-5(g) (emphasis added).

We, and every other circuit that has addressed the issue, have recognized that Congress, in enacting this section and providing for the recovery of back pay, did not make available the legal remedies of compensatory and punitive damages but instead limited relief to equitable remedies.[6] *See Bundy v. Jackson*, 641

[5] After the taxpayer makes this showing, he must then show that the amount was received as a result of a personal injury. I.R.C. § 104(a)(2).

[6] Several courts have characterized back pay as an equitable remedy akin to restitution. *Walker v. Ford Motor Co.*, 684 F.2d 1355, 1364 n.14 (11th Cir. 1982) (quoting *Richerson v. Jones*, 551 F.2d 918, 927 n.13 (3rd Cir. 1977)); *EEOC v. Detroit Edison Co.*, 515 F.2d 301, 309 (6th Cir. 1975). *See*

F.2d 934, 946 n.12 (D.C. Cir. 1981); *see also Cumpiano v. Banco Santander Puerto Rico*, 902 F.2d 148, 159 (1st Cir. 1990); *Carrero v. New York City Hous. Auth.*, 890 F.2d 569, 581 (2d Cir. 1989); *Mitchell v. Seaboard Sys. R.R.*, 883 F.2d 952, 955 (6th Cir. 1989); *Bennett v. Corroon & Black Corp.*, 845 F.2d 104 106 (5th Cir. 1988), *cert. denied*, 489 U.S. 1020 (1989); *Keller v. Prince George's County*, 827 F.2d 952, 955 (4th Cir. 1987); *Protos v. Volkswagen of Am., Inc.*, 797 F.2d 129, 138 (3rd Cir.), *cert. denied*, 479 U.S. 972 (1986); *Patzer v. Board of Regents*, 763 F.2d 851, 854 n.2 (7th Cir. 1985); *Muldrew v. Anheuser-Busch, Inc.*, 728 F.2d 989, 992 n.2 (8th Cir. 1984); *Walker v. Ford Motor Co.*, 684 F.2d 1355, 1363-1364 (11th Cir. 1982); *Shah v. Mt. Zion Hosp. & Medical Ctr.*, 642 F.2d 268, 272 (9th Cir. 1981); *Pearson v. Western Elec. Co.*, 542 F.2d 1150, 1152 (10th Cir. 1976).

While the Supreme Court has not spoken directly on the issue, it has reminded us on several occasions that not all awards of monetary relief are properly characterized as the "'legal' relief" traditionally awarded in courts of law. *Curtis*, 415 U.S. at 196 (1974); *see also Porter v. Warner Holding Co.*, 328 U.S. 395, 402 (1946) (equitable remedy of restitution "differs greatly" from damages). Moreover, in the seventh amendment context, the distinction between the legal remedy of damages and the equitable remedy of restitution has been consistently maintained. *See, e.g., Curtis*, 415 U.S. at 196 (1974). Because the available remedies are equitable, a Title VII

also Curtis v. Loether, 415 U.S. 189, 197 (1974) ("back pay [i]s an integral part of an equitable remedy, a form of restitution") (comparing relief available under Title VIII, 42 U.S.C. § 3612, with that available under Title VII).

plaintiff has no right to a jury trial. *Robinson v. Lorillard Corporation*, 414 F.2d 791, 802 (4th Cir.), *cert. dismissed*, 404 U.S. 1006 (1971); *Johnson v. Georgia Highway Express, Inc.*, 417 F.2d 1122, 1125 (5th Cir. 1969).

In sum, the overwhelming weight of authority supports the view that an award of back pay under Title VII does not constitute the legal remedy of damages. Accordingly, it is not excludable from income under section 104(a)(2).

C.

Our conclusion that back pay is taxable finds ample support in the case law. *See Thompson v. Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989) (back pay, as distinguished from liquidated damages portion of award, includable in gross income); *Johnston v. Harris County Flood Control Dist.*, 869 F.2d 1565, 1579-80 (5th Cir. 1989), *cert. denied*, 493 U.S. 1019 (1990) ("damages that constitute a back pay award under Title VII are not exempt under § 104(a)(2)"); *Watkins v. United States*, 223 Ct. Cl. 731 (1980) (back pay awarded under Title VII constitutes compensation for services and is includable in income); *Coats v. Commissioner*, 36 T.C.M. (P-H) 1642 (1977) (same); *Hodge v. Commissioner*, 64 T.C. 616 (1975) (same); *cf. Sears v. Atchison, Topeka & Santa Fe Ry.*, 749 F.2d 1451 (10th Cir. 1984) (trial court properly included tax component in Title VII award). We cannot disregard such substantial authority.

We recognize that our holding that a Title VII back pay award is not excludable from income conflicts with that of the Sixth Circuit. *See Burke v. U.S.*, 929 F.2d 1119 (6th Cir.), *cert. granted*, 60 U.S.L.W. 3217, 3220-21 (Oct. 7, 1991). It also conflicts with

the Third Circuit's rationale in *Rickel v. Commissioner*, 900 F.2d 655 (3rd Cir. 1990), where that circuit held that back pay awarded under the Age Discrimination in Employment Act (ADEA), 29 U.S.C. §§ 621-634 (1988), is excludable. *See also Pistillo v. Commissioner*, 912 F.2d 145 (6th Cir. 1990). In our view, these cases reflect a misapprehension of the inquiry required under section 104(a)(2).

In *Burke*, the Sixth Circuit relied on the decision of the full tax court in *Threlkeld v. Commissioner*, 87 T.C. 1294, 1299 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988), in concluding that a Title VII back pay award is excludable under section 104(a)(2). In *Threlkeld*, the Tax Court has stated:

> Section 104(a)(2) excludes from income amounts received as damages on account of personal injuries. Therefore, whether *the damages received* are paid on account of "personal injuries" should be the beginning and end of the inquiry. To determine whether the injury complained of is personal, we must look to the origin and character of the claim (citations omitted), and not to the consequences that result from the injury.

87 T.C. at 1299 (quoted in *Burke*, 929 F.2d at 1121) (emphasis added). Seizing on this language the Sixth Circuit then concluded that "whether the § 104(a)(2) exclusion applies requires an examination of the nature of the injury to determine whether the injury and claim are personal and tort-like in nature, and not whether the consequences of the injury resulted in an award of compensatory damages or *damages for back pay*." *Burke*, 929 F.2d at 1121 (emphasis added). In one sentence, the Sixth Circuit leapfrogged over the damages requirement directly to the

personal injury inquiry, at the same time fusing the distinction between damages and back pay universally recognized in Title VII cases.

To us, the Sixth Circuit's decision is irreconcilable with Title VII precedent and misinterprets *Threlkeld* to boot. The holding in *Threlkeld* speaks only to the rule for determining whether a particular claim constitutes a "personal injury" under section 104(a)(2). So limited, it makes complete sense to examine the "origin and character of the claim" and not its consequences in determining whether it constitutes a claim for personal injuries. In *Threlkeld*, then, the Tax Court properly held that the injury to the taxpayer's professional reputation arising out of a malicious prosecution was a personal injury even though the direct consequence of that injury was lost income. But in *Threlkeld* the taxpayer was entitled to recover *damages* under state law for his injury, *see* 87 T.C. at 1308, and thus both requirements of section 104(a)(2) were satisfied. Here, however, as in *Burke*, the taxpayer did not recover damages. Labelling "back pay" as damages, as the Sixth Circuit did, not only conflicts with the Supreme Court's teaching that not all awards of monetary relief constitute the legal remedy of damages, *Curtis v. Loether*, 415 U.S. at 196; *Porter v. Warner Holding Co.*, 328 U.S. at 402; it also ignores the unanimous circuit court decisions holding that Title VII does not provide for damage awards.

For similar reasons, we also reject the approach taken by the Third Circuit in *Rickel*. Rickel relies on the legislative history of the amendment to section 104(a)(2) effected by the Omnibus Budget Reconciliation Act of 1989, 103 Stat. 2379. In *Rickel*, the Third Circuit noted that the bill initially would have amended section 104(a)(2) to limit the excludability

of damage awards to those arising out of physical injuries and sickness. 900 F.2d at 664. The *Rickel* court found it significant that the House Ways and Means Committee report on the bill observed that "come courts have held that the exclusion applies to damages in cases involving employment discrimination" but the "committee believes that such treatment is inappropriate where no physical injury or sickness is involved." *Id.* (citations omitted). Because Congress did not adopt this provision but did amend section 104(a)(2) to provide for the taxation of punitive damage awards, the *Rickel* court concluded that "Congress chose to implicitly endorse the courts' expansive interpretation of § 104(a)(2)." *Id.*

Inferring congressional intent from the failure to enact a legislative proposal is frequently a risky enterprise, *cf. Avco Corp. v. United States Dep't of Justice*, 884 F.2d 621, 625 (D.C. Cir. 1989), and we find the Third Circuit's rationale unpersuasive for several reasons. First, while we acknowledge that at the time the amendment was considered, the holding in *Metzger v. Commissioner*, 88 T.C. 834 (1987), *aff'd without published opinion*, 845 F.2d 1013 (3d Cir. 1988), that back pay awarded under Title VII was excludable from income had issued, our research indicates that it was the only case which had so held and was contrary to the weight of authority. *See, e.g., Thompson v. Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989); *Watkins*, 223 Ct. Cl. at 733; *Hodge*, 64 T.C. at 619; *Coats*, 46 T.C.M. (P-H) at 1644; *see also Pistillo v. Commissioner*, 58 T.C.M. 1623 (P-H) (1989); *Wirtz v. Commissioner*, 58 T.C.M. 647 (P-H) (1989). Congress could have rightfully concluded that *Metzger* was nothing more than "a deviation from the strong currents of precedent - a derelict on the waters of the law," *Lambert v. California*,

355 U.S. 225, 232 (1957) (Frankfurter, J., dissenting), and thus viewed the adoption of the amendment as unnecessary.

Second, even were we to derive the same significance that the Third Circuit did from Congress's failure to enact the proposal to tax damages awarded on account of discrimination claims, it would be irrelevant to the issue before us. Here, unlike *Rickel*, we do not address whether a monetary award received through the prosecution of a claim under the ADEA, a statute which allows for the recovery of damages, is excludable from income under section 104(a)(2). *See, Powers v. Ginnell Corp.*, 915 F.2d 34 (1st Cir. 1990). Rather, we deal solely with Title VII which does not provide for the recovery of damages. Because only damages are excludable from income under section 104(a)(2), there was, and is, no need for Congress to act. This legislative history is simply beside the point.[7]

What is relevant in the history of section 104(a)(2) is an understanding of the principle which underlies its enactment. Shortly before the enact-

[7] In *Rickel*, the Third Circuit also relied on *Byrne v. Commissioner*, 883 F.2d 211 (3d Cir. 1989). In *Byrne*, the taxpayer had been discharged for cooperating with an EEOC investigation of her employer. 883 F.2d at 212. Byrne brought claims under both section 215(a)(3) of the Fair Labor Standards Act, 29 U.S.C. § 215(a)(3), which prohibits discharging or discriminating against an employee for testifying against an employer, and New Jersey law. 883 F.2d at 215. To redress violations of section 215, Congress expressly provided for both legal and equitable relief, including liquidated damages. 29 U.S.C. § 216(b). There was, then, a basis for the Third Circuit's conclusion that Byrne's award was excludable under section 104(a)(2): it constituted damages. Moreover, damages were also recoverable under New Jersey law. 883 F.2d at 216.

ment of the predecessor statute to section 104(a)(2), the United States Attorney General had concluded that "the proceeds of an accident insurance policy [we]re not 'gains or profits and income' " but instead represented a return of capital not taxable under the Supreme Court's holding in *Doyle v. Mitchell Brothers Co.*, 247 U.S. 179, 185 (1918). 31 Op. Att'y. Gen. 304 (1918). Only two years later, the Internal Revenue Service noted that section 213(b)(6) of the Revenue Act of 1918, the predecessor of section 104(a)(2), was "merely declarative of th[is] conclusion . . . and intended to go no further." S. 1384, 2 C.B. 71, 72 (1920) (citing 31 Op. Att'y Gen. 304 (1918)). The Internal Revenue Service then noted that a "personal injury not resulting in the destruction or diminution of a capital asset would not be within the exemption." *Id.* at 72.

Viewed against this background, we conclude that section 104(a)(2) does not make a Title VII back pay award excludable from income. An award of back pay simply does not represent a return of capital. It represents back wages which, although belatedly received, are nevertheless income.

III.

Our view that a back pay award is includable in income is also consistent with the congressional purpose underlying Title VII. The remedies available under Title VII exist to make whole the employee discriminated against, that is, to place him in the same position he would have been in but for the discrimination, but not to compensate beyond that. *See Albemarle Paper Co. v. Moody*, 422 U.S. 405, 421 (1975) ("[t]he central statutory purposes" of Title VII are "eradicating discrimination throughout the economy and making persons whole for injuries suf-

fered through past discrimination"). The Section-by-Section Analysis introduced by Senator Williams at the time the back pay provisions were enacted as part of the Equal Employment Opportunity Act of 1972 stated:

> The provisions of this subsection [the back pay subsection now codified at 42 U.S.C. § 2000e-5(g)] are intended to give the courts wide discretion exercising their *equitable powers* to fashion the most complete relief possible. In dealing with the present section 706(g) the courts have stressed that the scope of relief under that section of the Act is intended to make the victims of unlawful discrimination whole, and that the attainment of this objective rests only only upon the elimination of the particular unlawful employment practice complained of [through cease and desist orders], but also requires that persons aggrieved by the consequences and effects of the unlawful employment practice be, *so far as possible, restored to a position where they would have been were it not for the unlawful discrimination.*

118 Cong. Rec. 7168 (1972) (quoted in *Albemarle Paper Co.*, 420 U.S. at 421) (emphasis added).

The taxing of a back pay award is consistent with the purpose of Title VII because it places the employee who has been discriminated against in the same position as if he had not been discriminated against, no more and no less. Had Sparrow remained employed by the Navy, he would have received a salary from the Navy and been required to pay federal income tax on it. Congress, in enacting Title VII, chose to limit the scope of the remedies available in redressing Sparrow's claim of discrimination. To hold that back

pay is excludable from income would give Sparrow something more than he is entitled to under Title VII. In effect, it would give him a tax benefit thus placing him in a better position than had he not allegedly been discriminated against. In view of the injury Sparrow asserted, such a result might seem fair. But it would be contrary to congressional intent as evidenced by the explicit provisions of Title VII.

IV.

Having concluded that Sparrow's back pay award does not constitute damages, we need not decide whether a claim of racial discrimination constitutes a "personal injury" under section 104(a)(2).[8] Accordingly, the decision of the Tax Court is

Affirmed.

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[8] The court notes that Title VII has been amended by the newly-enacted legislation generally known as the Civil Rights Act of 1991, S. 1745, 102d Cong., 1st. Sess. (1991).

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No. 91-42

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

UNITED STATES OF AMERICA,

Petitioner,

—v.—

THERESE A. BURKE, *et al.*,

Respondents.

ON WRIT OF *CERTIORARI* TO THE
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF *AMICUS CURIAE* OF THE AMERICAN CIVIL LIBERTIES UNION, NOW LEGAL DEFENSE AND EDUCATION FUND, AND NAACP LEGAL DEFENSE AND EDUCATIONAL FUND, IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICI CURIAE*[1]

The American Civil Liberties Union ("ACLU") is a nationwide, nonpartisan organization of almost 300,000 members, dedicated to protecting fundamental rights, including the right to equal treatment under the law. The ACLU has established the Women's Rights Project to work towards the elimination of the pervasive problem of gender-based discrimination. It is also involved in challenges to many other forms of discrimination including discrimination based on race, national origin, religion and disability. The ACLU has participated, both directly and as *amicus curiae*, in the litigation of many cases before the Supreme Court and other courts challenging various discriminatory practices. It submits this brief to support the proposition that victims of discrimination, like victims of other forms of wrongful conduct, should not be required to pay taxes on amounts recovered for violations of their legal rights.

The NAACP Legal Defense and Educational Fund, Inc., is a nonprofit corporation organized under the laws of the State of New York as a legal aid society. It was formed to assist African Americans to secure their constitutional and civil rights through the courts. For many years, its attorneys have represented parties and appeared as *amicus curiae* in this Court and in the lower federal courts on a broad range of issues, including both the substantive and procedural law relevant to cases of racial discrimination. It submits this brief because, if the government's position is sustained in the present case, the effectiveness of the remedies for discrimination will be significantly diminished and the burdens imposed on employers and employees by treating awards as taxable income will make settlement more difficult.

The NOW Legal Defense and Education Fund ("NOW LDEF") was established as a nonprofit women's rights law center in 1970 by founders of the National Organization for Women, and since that time has consistently worked on

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1. Letters of consent to the filing of this brief have been lodged with the Clerk of the Court pursuant to Supreme Court Rule 37.3.

important legal cases and in advocacy and public education concerning the rights of women. NOW LDEF has particular concern for discrimination against women in the workplace, and supports efforts to address the injuries arising from such discrimination. Consistent with these efforts, it submits this brief.

SUMMARY OF ARGUMENT

Since 1918, under what is now I.R.C. § 104(a)(2),[2] Congress has excluded from gross income "any damages" that are received on account of a "personal injury." This exclusion has applied without regard to whether the injury is physical or nonphysical, and the courts and the Commissioner have uniformly so held.

Consistent with the terms of the statute and this Court's holding in *United States v. Gilmore*, 372 U.S. 39, 44 (1963), the Courts of Appeals and the Tax Court have unanimously looked to the "nature of the *claim*" to determine the applicability of § 104(a)(2). The nature of the *damages* is irrelevant. Once a victim has suffered a personal injury, § 104(a)(2) excludes from gross income all damages for both economic consequences (*e.g.*, lost wages) and noneconomic consequences (*e.g.*, pain and suffering). In accord with this test, four Courts of Appeals have held that recoveries for discrimination under Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e *et seq.* (1988), and other anti-discrimination statutes constitute damages received on account of a personal injury. The "nature of the claim" test is consistent with this Court's precedent and is analytically sound. It should be upheld.

The Commissioner would have this Court establish a different standard. First, the Commissioner urges that § 104(a)(2) should be read to divide personal injuries into "physical" and "nonphysical" injuries. Second, the Commissioner has proposed that § 104(a)(2) should exclude from gross income recoveries for nonphysical injuries only to the extent they constitute a "return of capital."

This Court should reject the Commissioner's interpretation of § 104(a)(2). The separation of physical and nonphysical injuries conflicts with the clear terms of the statute, which make no distinction between physical and nonphysical injuries. Moreover, this proposed distinction has been expressly rejected by Congress, leads to capricious results, has been rejected by five Courts of Appeals and the Tax Court, and would inevitably lead to the taxation of damages for physical injuries as well.

The Commissioner's second proposal should also be rejected because it, too, is at odds with the clear language of the statute itself and suffers from several additional flaws. First, the Commissioner's proposed test fails to recognize that attributes such as integrity, self-respect, and dignity are as much a part of "human capital" as are arms and legs. Second, the test is without basis in the Tax Code and is technically and logically flawed. Third, the Commissioner's test would render § 104(a)(2) superfluous for nonphysical injuries: If § 104(a)(2) applied only to a "return of capital," the provision would serve no purpose because a "return of capital" does not constitute income. Finally, this additional test relies upon a confusing theory of return of human capital that is of uncertain scope and application.

For all of the above reasons, the arguments offered by the Commissioner should be rejected. The judgment of the Court of Appeals should be affirmed.

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2. Internal Revenue Code (26 U.S.C.) § 104(a)(2) (hereinafter I.R.C. or the Code).

ARGUMENT

I. For over seventy years Congress and the courts have excluded from gross income damages received on account of any personal injury, including both physical and nonphysical injuries. The Commissioner adds into section 104(a)(2) a distinction between physical and nonphysical injuries that conflicts with the plain terms of the statute, has no legislative or judicial support, and is logically flawed.

Section 61(a) of the Code, which is the statutory starting point for a determination of gross income, provides that, except as otherwise stated in the Code, gross income includes "all income from whatever source derived." All accessions to wealth realized by a taxpayer are therefore presumed to be gross income and taxable, unless the taxpayer can demonstrate that an accession fits into one of the specific exclusions created elsewhere in the Code. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430 (1955) (Congress intended to tax all gains except those specifically exempted).[3] One such exclusion is codified at I.R.C. § 104(a)(2), which states:

> [G]ross income does not include . . . (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness . . . .

In interpretation of the statute, Treas. Reg. § 1.104-1(c) further provides: "The term 'damages received (whether by suit or agreement)' means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort-type rights, or through a settlement

3. The parties have apparently agreed that the award represents an "accession to wealth." *See* Brief for the United States at 9 (hereinafter SG Brief). This determination, however, is a question of law subject to *de novo* review by this Court. *See Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955); *see also National-Standard Co. v. Commissioner*, 749 F.2d 369, 371 (6th Cir. 1984).

agreement entered into in lieu of such prosecution." An examination of the statute itself, the circumstances surrounding its enactment, and subsequent judicial interpretations demonstrates that Congress intended to exclude from income all damages, including back pay, received on account of any personal injury, including nonphysical injuries such as discrimination.

In 1918, Congress enacted the legislative predecessor of what is now § 104(a)(2). Although Congress apparently shared the then-widespread belief that damages received on account of personal injuries were not even within the Sixteenth Amendment's definition of income,[4] Congress wished to ensure that victims of personal injury would receive any recoveries for the injury free of taxation. Accordingly, § 213(b)(6) of the Revenue Act of 1918 excluded from gross income the following:

> Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness.

Revenue Act of 1918, Pub. L. No. 65-254, ch. 18, § 213(b)(6), 40 Stat. 1057, 1065-66. The provision has continued to the present with only minor modifications.[5] It currently excludes

4. The legislative history of the Revenue Act of 1918 reflects this belief:

> Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages received on account of such injuries or sickness, are required to be included in gross income.

H.R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1918).

5. In its rearrangement of existing law in 1954, Congress chose to separate the provisions relating to the exclusion for workmen's compensation payments, accident and health insurance proceeds, and damages for personal injury recoveries. *See* I.R.C. § 104(a). The regulations follow this division. This isolation of "personal injury" from other recoveries, such as accident and

(continued...)

from gross income "the amount of any damages received . . . on account of personal injuries or sickness." I.R.C. § 104(a)(2).

Since its inception in 1918, § 104(a)(2) has therefore excluded from gross income all damages received by a victim of a personal injury on account of that injury. The provision has never contained any distinction between physical and nonphysical injuries.

A. The Commissioner's distinction between physical and nonphysical injuries conflicts with the plain terms of the statute and creates a restriction on section 104(a)(2) that Congress considered and rejected.

Despite the clear terms of the statute excluding damages for "personal injury" without regard to physical or nonphysical injuries, the Commissioner proposes a test that would accord different treatment to damages depending upon whether those damages were received on account of a physical personal injury or a nonphysical personal injury. SG Brief at 14, 20-21. It is well-settled that "the words of statutes -- including revenue acts -- should be interpreted where possible in their ordinary, everyday senses." *Crane v. Commissioner*, 331 U.S. 1, 6 (1947). As three Courts of Appeals have noted in this context: "The ordinary meaning of a personal injury is not limited to a physical one." *Roemer v. Commissioner*, 716 F.2d 693, 697 (9th Cir. 1983).[6]

Moreover, the Commissioner's distinction between physical and nonphysical injury was recently considered and rejected by Congress. In 1989, the House of Representatives

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5.(...continued)
health insurance proceeds, provides further support that Congress believed that personal injuries may be more than purely physical.

6. This passage is quoted with approval in *Bent v. Commissioner*, 835 F.2d 67, 70 (3d Cir. 1987). *See Pistillo v. Commissioner*, 912 F.2d 145, 148 (6th Cir. 1990) ("the meaning of 'personal injuries' encompasses both physical and nonphysical injuries").

approved a provision that would have limited the exclusion of § 104(a)(2) to amounts received on account of physical injury. The proposal was intended to reverse recent court decisions broadly interpreting § 104(a)(2) "to cover awards for personal injury that do not relate to a physical injury," such as "cases involving employment discrimination and injury to reputation where there is no physical injury or sickness." H.R. Rep. No. 247, 101st Cong., 1st Sess. 1354-55, *reprinted in* 1989 U.S.C.C.A.N. 2824-25. At the time of the proposal, four Courts of Appeals and the Tax Court had interpreted § 104(a)(2) to exclude from gross income all damages received on account of a nonphysical personal injury, such as employment discrimination or defamation.[7]

The Conferees rejected the House proposal and refused to limit the exclusion in § 104(a)(2) to recoveries for physical injuries. Instead, Congress passed a much narrower provision that limited the scope of the exclusion for punitive damages. Under this provision, punitive damages from a nonphysical injury are now outside the scope of § 104(a).[8] Section 104(a) remained unaltered in all other respects.

B. The distinction between physical and nonphysical injuries has been rejected by five Courts of Appeals and the Tax Court.

The Commissioner's interpretation conflicts with the unanimous holdings of five Circuit Courts and the Tax Court. The Third, Fourth, Sixth, Ninth, and Tenth Circuit Courts of Appeals have determined that § 104(a)(2) covers damages from both physical and nonphysical injuries in equal measure.

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7. *See Wulf v. City of Wichita*, 883 F.2d 842 (10th Cir. 1989); *Thompson v. Commissioner*, 866 F.2d 709 (4th Cir. 1989); *Threlkeld v. Commissioner*, 848 F.2d 81 (6th Cir. 1988), *aff'g* 87 T.C. 1295 (1986); *Bent*, 835 F.2d 637; *Roemer v. Commissioner*, 716 F.2d 693 (9th Cir. 1983).

8. *See* Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7641(a), 103 Stat. 2106, 2379 (1989) (codified at 26 U.S.C. § 104 (Supp. I 1989)).

Commissioner v. Miller, 914 F.2d 586, 589 (4th Cir. 1990) (defamation action is action for personal injuries); *Pistillo v. Commissioner*, 912 F.2d 145, 148 (6th Cir. 1990) ("the meaning of 'personal injuries' encompasses both physical and nonphysical injuries"); *Rickel v. Commissioner*, 900 F.2d 655, 658 (3d Cir. 1990) ("personal injuries" under § 104(a)(2) encompass both physical and nonphysical injuries); *Thompson v. Commissioner*, 866 F.2d 709, 711 (4th Cir. 1989) ("relevant distinction [is] . . . not between physical and nonphysical injuries"); *Bent v. Commissioner*, 835 F.2d 67, 70 (3d Cir. 1987) ("ordinary meaning" of personal injury includes both physical and nonphysical injuries); *Roemer*, 716 F.2d at 697 (finding "ordinary meaning" of personal injury to include both physical and nonphysical injuries); *Threlkeld v. Commissioner*, 87 T.C. 1294, 1297 (1986) ("[n]o distinction is made between physical and nonphysical . . . injuries"), *aff'd*, 848 F.2d 81 (6th Cir. 1988). Even the Commissioner has ruled that compensation for lost income received on account of a nonphysical injury is not taxable income. *See* Rev. Rul. 85-143, 1985-2 C.B. 55; Rev. Rul. 85-98, 1985-2 C.B. 51 (both holding that nonphysical injuries are within the scope of § 104(a)(2)); Rev. Rul. 56-518, 1956-2 C.B. 25 ("damage to . . . professional or economic advancement" from Nazi persecution not taxable).

Not a single court has advanced any distinction between physical and nonphysical injuries in determining the scope of § 104(a)(2) and its predecessors. The courts have specifically declined to do so when urged by the Commissioner. *See, e.g., Bent*, 835 F.2d at 70; *Church v. Commissioner*, 80 T.C. 1104, 1106 (1983). This Court should not impose such a distinction now.

C. The Commissioner's proposed distinction leads to capricious results.

The distinction between physical and nonphysical injuries results in disparate treatment of similarly situated taxpayers under § 104(a)(2). As the Tax Court noted in its *en banc*

opinion[9] in *Threlkeld*, if a tortfeasor causes a surgeon to lose a finger, the loss will cause both noneconomic consequences (*e.g.*, pain and suffering) and economic consequences (*e.g.*, lost income). The entire amount of damages received is excludable. 87 T.C. at 1300. If the surgeon's injuries were nonphysical (*e.g.*, defamation), the Commissioner would require that courts "delve[] into an inquiry regarding the nature of the consequences of the injury," *id.* at 1300-01, to determine which portion of the award represented a recovery for economic consequences and which portion represented a recovery for noneconomic consequences. For nonphysical injuries, the Commissioner would tax the recovery for economic consequences as an accession to wealth: The lost income would have been taxable when earned. SG Brief at 21. *See* Rev. Rul. 72-341, 1972-2 C.B. 32. There is no logical basis for this distinction between these two tort victims, and this Court should not accept it. There is no reason to believe that Congress intended such inconsistencies. "We should be slow to attribute to Congress a purpose producing such unequal treatment among taxpayers, resting on no rational foundation." *Gilmore*, 372 U.S. at 48.

D. There is no logical means to distinguish between physical and nonphysical injuries.

The Commissioner's distinction between physical and nonphysical injuries is semantic and arbitrary. No principle of taxation provides any guidance for differentiating between recoveries for physical and nonphysical injuries.

The practical problems of the Commissioner's proposed test are immediately apparent. A taxpayer whose back is broken suffers both broken bones and mental pain and suffering. He may also suffer a loss of wages if he is subsequently fired from his job. The Commissioner's test would require courts to determine whether the firing took place as a result of the physical injury (impaired mobility) or the

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9. Technically, the Tax Court does not sit *en banc* but rather reviews certain decisions as a "Full Court."

nonphysical injury (depression and anxiety). Similarly, a victim of discrimination on the job may suffer both an affront to her dignitary interests and headaches, ulcers, as well as other ailments. It becomes impossible as a practical matter to differentiate the harm from the effect on the tort victim.

There is no principle of taxation that would enable courts to make the distinctions in the Commissioner's proposed test. Both an arm and intellect, for example, constitute human capital. *See Hawkins v. Commissioner*, 6 B.T.A. 1023, 1025 (1927) (reputation as human capital); 31 Op. Att'y Gen. 304 (1918) (human body as "a kind of capital"), *quoted in* Sol. Op. 1384, 2 C.B. 71, 72 (1920). Both can be damaged or diminished. Both can generate income. Neither has basis. *See United States v. Garber*, 589 F.2d 843, 849-50 (5th Cir.) (Clark, J., dissenting), *rev'd*, 607 F.2d 92 (5th Cir. 1979).

The only apparent distinction between a physical injury and a nonphysical injury is the nature of the causal relation between harm and effect. The causal relation between physical intrusion and the resultant injury is often more readily perceived simply because there is tangible evidence showing the connection. This evidentiary difference, however, does not provide any principled means of separating the two types of injury and certainly has no relevance in taxation. From a tax perspective, this proposed distinction is plainly and simply arbitrary. This Court should reject the Commissioner's attempt to require the courts to make such unprincipled distinctions.

E. The inexorable consequence of the Commissioner's test is taxation of damages for physical injuries.

The Commissioner's theory regarding nonphysical injuries would logically lead to taxation of damages for physical injuries, reversing over seventy-five years of unbroken precedent and tax policy. The Commissioner's theory regarding taxation of damages for nonphysical injuries is simple. First, a back pay award for work performed represents an accession to wealth because it is a substitute for wages for services already provided, which would have been taxed as income if received currently

during employment.[10] SG Brief at 7. (The Commissioner also extends this reasoning to wages received for wrongful termination. *Id.* at 26 n.20.) Second, because such a recovery represents an accession to wealth, the exclusion of § 104(a)(2) would not be available under the Commissioner's test because the taxpayer could not establish that the recovery was a "reimbursement for a prior loss of personal 'capital.' " *Id.* at 14-15.

This logic cannot be limited to nonphysical injuries. It applies with equal force to a pianist or surgeon whose hands are injured, or a construction worker whose back is injured, or a schoolteacher whose voice is impaired. The lost wages in Rev. Rul. 61-1, 1961-1 C.B. 14, for example, would be taxable because they would have been taxable when earned.

Indeed, the logic of the Commissioner's position is not limited to back pay. Future earnings, like past earnings, are subject to tax when earned. Therefore, a recovery for loss of future earnings cannot be a tax-free return of capital. In sum, the logic of the Commissioner's circular reasoning has no stopping point except the full taxation of all damages measured by past or future loss of earnings. This reasoning would overturn almost seventy-five years of tax law excluding these recoveries from taxation.

The dramatic changes which would result from accepting the argument urged by the Commissioner have been considered and rejected by Congress. They should also be rejected by this Court.

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10. This concept is discussed critically in Knickerbocker, *The Income Tax Treatment of Damages: A Study in the Difficulties of the Income Concept*, 47 Cornell L.Q. 429, 435 (1962). *Amici* believe that respondents' recovery does not represent back wages for the reasons stated *infra* p. 15 & n.16.

II. In applying section 104(a)(2), the Courts of Appeals and the Tax Court have looked to the nature of the claim asserted by the victim. They have made no distinction between economic and noneconomic damages from personal injuries.

A personal injury will often involve both economic consequences, such as lost wages, and noneconomic consequences, such as pain and suffering.[11] A surgeon whose hand is disabled or a baseball player whose back is injured will suffer both bodily pain and mental distress (noneconomic consequences) and lost wages (economic consequences). Valuation of a lost hand or a bad back can be so difficult that ultimately a victim may resort to the use of an economic yardstick to demonstrate the extent of the harm he has suffered, even though the noneconomic consequences may constitute the bulk of the harm.[12]

Congress apparently has recognized that a personal injury frequently entails both economic and noneconomic consequences and has written § 104(a)(2) to exclude both. Under the terms of § 104(a)(2), "*any* damages" are excluded so long as they are received on account of a personal injury (emphasis added).

11. The Courts of Appeals also use the term "nonpersonal consequences" to describe economic consequences and "personal consequences" to describe noneconomic consequences. *See, e.g., Bent*, 835 F.2d at 70; *Roemer*, 716 F.2d at 699. This brief uses the economic/noneconomic distinction merely to avoid confusion between a "personal injury" and its consequences, which can be both "personal" and "nonpersonal."

12. As the revenue solicitor noted over sixty years ago:

> The [personal] rights on the one hand and the money on the other are incomparable things which can not be placed on opposite sides of an equation. [Such a] personal right . . . is not assignable and not susceptible of any appraisal in relation to market values . . . .

Sol. Op. 132, I-1 C.B. 92, 93 (1922).

A. The Courts of Appeals and the Tax Court have concluded that a "nature of the claim" test implements the intent of section 104(a)(2).

In following the clear wording of the statute, the Circuit Courts and the Tax Court have unanimously concluded that § 104(a)(2) requires only that a court determine whether damages have been received on account of a personal injury. The fact that some of the damages may represent recoveries for economic consequences is of no import in assessing the taxability of damages. So long as the "nature of the claim" is that of a claim for personal injury, the resultant damages are excluded under § 104(a)(2).

An often-cited articulation of this "nature of the claim" test is in *Threlkeld*:

> Section 104(a)(2) excludes from income amounts received as damages on account of personal injuries. *Therefore, whether the damages received are paid on account of "personal injuries" should be the beginning and end of the inquiry.* To determine whether the injury complained of is personal, we must look to the origin and character of the claim . . . , and not to the consequences that result from the injury.

87 T.C. at 1299 (citations omitted) (emphasis added).[13] The Third, Sixth, Ninth, and Tenth Circuits have adopted this test, and the Fourth Circuit has adopted it in part.[14]

13. In *Threlkeld*, the Tax Court held that § 104(a)(2) excluded from gross income a malicious prosecution settlement attributable to injury to the taxpayer's professional reputation because the amount constituted damages received on account of personal injuries. *See* 87 T.C. at 1308.

14. *Pistillo*, 912 F.2d at 148 (3d Cir.); *Threlkeld*, 848 F.2d at 84 (6th Cir.); *Redfield v. Insurance Co. of N. Am.*, 940 F.2d 542, 544-45 (9th Cir. 1991); *Wulf*, 883 F.2d at 872-73 (10th Cir.). The Fourth Circuit, in *Thompson*, 866 F.2d at 712, seems to have adopted a bifurcated test. The *Thompson* court began with the proposition that the tax treatment of an award of liquidated damages and back pay received in a suit under Title VII and the Equal Pay Act turns on whether "the awards were received for personal

(continued...)

The courts' uniform adoption of a "nature of the claim" analysis is appropriate for four reasons. First, and most important, the test is consistent with the statute's clear reference to "any damages," and makes no distinction among the damages that may be received on account of personal injury.[15]

Second, the use of a "nature of the claim" test to determine the nature of damages received on account of litigation comports with this Court's holdings in the analogous area of the characterization of the consequences of litigation. In *Gilmore*, 372 U.S. 39, this Court held that the expense of defending a divorce suit was a nondeductible personal expense (rather than a deductible business expense) because its origin was personal rather than from the taxpayer's business. The Court expressly rejected a test based upon the consequences of the litigation:

> The principle we derive . . . is that the characterization, as "business" or "personal," of the litigation costs of resisting a claim depends on whether or not the claim *arises in connection with* the taxpayer's profit-seeking activities. It does not depend on the *consequences* that might result to a taxpayer's income-producing property from a failure to defeat the claim . . . . [S]uch a rule would lead to capricious results.

Id. at 48 (emphasis in original); *see Woodward v. Commissioner*, 397 U.S. 572, 577-78 (1970). Like the "consequences test" rejected in *Gilmore* and *Woodward*, the Commissioner's reliance here on the consequences of personal injury litigation would "encourage resort to formalisms and artificial distinctions." *Id.* at 577.

Third, the "nature of the claim" approach is analytically sound because it avoids confusion between the personal injury itself and its consequences. As the Ninth Circuit noted:

> Although there are different types of defamation actions (libel or slander) depending on the form of the defamatory statements, all defamatory statements attack an individual's good name. This injury to the person should not be confused with the derivative consequences of the defamatory attack, *i.e.*, the loss of reputation in the community and any resulting loss of income. . . . The *personal nature of an injury* should not be defined by its effect.

Roemer, 716 F.2d at 699 (footnote omitted) (emphasis added).

Finally, the "nature of the claim" test avoids confusion between what constitutes "damages" under § 104(a)(2) and how those damages, once found, are measured. Back pay or a similar economic yardstick is often simply used as a workable and expeditious means of measuring damages to a person's dignitary rights. Congress and the courts have used such measurements as a matter of convenience to protect rights that cannot be valued with any precision. As the Ninth Circuit has noted: "The *nonpersonal consequences* [*i.e.*, an economic yardstick] of a personal injury, such as a loss of future income, are often the most persuasive means of proving the extent of the injury that was suffered." *Roemer*, 716 F.2d at 699 (emphasis added).[16]

14.(...continued)
injuries through prosecution of a legal action based upon tort or tort-type rights." *Id.* at 711. That is the *Threlkeld* test. The court then determined that a sex discrimination claim is a tort-type action. *Id.* at 712. The entire award, therefore, should have been excluded under § 104 (a)(2). The court, however, then focused on the nature of the damages received and determined that the liquidated damages award was excludable as compensatory damages, but the back pay award was not excludable because it was in the nature of a breach-of-contract award. *Id.*

15. As noted *supra* pp. 6-7, in 1989 Congress did exempt punitive damages for nonphysical injury from § 104(a)(2). Punitive damages are not at issue in this case.

16. *See Threlkeld*, 848 F.2d at 84 (loss of future income "often the most persuasive means of proving the extent of the injury that was suffered" and "personal nature of an injury should not be defined by its effect"); *Bent*, 835 F.2d at 70 ("an award of damages for the violation of a constitutional right may be measured in whole or in part by the amount of lost wages"); *Metzger v. Commissioner*, 88 T.C. 834, 858 (1987), *aff'd without opinion*, 845 F.2d 1013 (3d Cir. 1988) (loss of income may merely be an evidentiary factor or the best measure of loss).

B. The Commissioner's proposed test is at odds with the statute and this Court's precepts in *Woodward* and *Gilmore*, and is based on an inapplicable theory regarding the taxation of damages.

The Commissioner disregards the clear terms of the statute that exclude "any damages" and instead proposes a test that distinguishes between economic and noneconomic consequences. According to the Commissioner, for nonphysical injuries, any receipt of back pay[17] (damages for economic consequences) represents an accession to wealth that should be taxed upon receipt by the tort victim. There is no basis in law or logic for such a distinction, and this Court should reject it.

First, there is no basis in the statute for distinguishing among different consequences from a personal injury. The statute states "any damages." It contains no qualification. Any further elaboration would make it " 'read like an insurance company's form [of] general release rather than a statute.' " *United States v. James*, 478 U.S. 597, 604 n.5 (1986) (quoting *James v. United States*, 760 F.2d 590, 604 (5th Cir. 1985) (Gee, J., dissenting)). Despite the long history of a fully inclusive definition of damages,[18] Congress has restricted § 104(a) only with respect to punitive damages for nonphysical injuries. Congress knows how to differentiate among types of damages for personal injury, yet it has declined to make the distinction the Commissioner now proposes.

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17. Under the Commissioner's theory, "back pay" includes not only wages for work already performed, but also wages received for a wrongful discharge, where no work was performed. SG Brief at 18, 26 n.20.

18. The Commissioner has long held that § 104(a)(2) excludes recoveries attributable to back pay. Rev. Rul. 61-1, 1961-1 C.B. 14. The courts have also construed damages from personal injury to include a broad range of harms. *McDonald v. Commissioner*, 9 B.T.A. 1340, 1341 (1928) (excluding from gross income damages for breach of contract to marry, including "loss of station to which the marriage would have advanced plaintiff").

Moreover, although the Commissioner has repeatedly attempted to have courts accept a distinction between economic and noneconomic consequences, these attempts have met with a string of defeats. In *Roemer*, 716 F.2d at 697, the Ninth Circuit found no basis for distinguishing between economic recoveries (*e.g.*, lost wages) and noneconomic recoveries (*e.g.*, pain and suffering): Section 104(a)(2) applied even "when the predominant result of the injury is a loss of income." Following the decision in *Roemer*, the full Tax Court (by a 15-1 vote) and the Third, Sixth, and Tenth Circuits also rejected any distinction between economic and noneconomic consequences.[19]

In an attempt to find some support for his proposed distinction, the Commissioner argues that the taxability of recoveries should be determined under the principle that damages should be taxed in the same manner as the items they replace. SG Brief at 17. Back pay for lost wages, for example, would be taxable when received as damages because they would have been taxable when earned. This "substitution principle" is based on the theory that a payment received in settlement of a claim is simply a substitute for what the taxpayer would have received if there had been no dispute between the parties in

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19. *Rickel v. Commissioner*, 900 F.2d 655, 661 (3d Cir. 1990) (nature of claim controlled; irrelevant whether damages, including back pay, compensate taxpayer for economic losses); *Byrne v. Commissioner*, 883 F.2d 211, 214 (3d Cir. 1989) ("relevant inquiry" in concluding settlement under New Jersey anti-discrimination law excludable "is whether the settlement was received on account of personal or non-personal injuries, not whether the damages compensate the taxpayer for economic losses"); *Bent*, 835 F.2d at 70 (3d Cir.) (settlement for First Amendment violation "admittedly" based on lost wages excludable; loss of future wages "often the most persuasive means" of proving extent of injury); *Pistillo*, 912 F.2d at 150 n.6 (6th Cir.) (specifically rejecting the Commissioner's proposed distinction in ADEA action between award of back pay and compensation for loss of human capital: "[W]hether [defendant] paid [the taxpayer] a portion of the settlement award to compensate him for pain and suffering or lost back pay is irrelevant to the § 104(a)(2) inquiry"); *Wulf*, 883 F.2d at 872-73 (10th Cir.) (award for lost wages -- including the portion of the recovery specifically representing back pay -- was excludable under § 104(a)(2) for First Amendment violation); *Threlkeld*, 87 T.C. at 1308 (damages received in settlement of malicious prosecution suit, including those for injuries to professional reputation, are excludable under § 104(a)(2)).

the first place. *See Church*, 80 T.C. at 1108; Fouts, *Payments Received in Settlement of Litigation and Claims*, 25 N.Y.U. Inst. Fed. Txn. 555, 556 (1966). This argument is flawed for two reasons. First, the argument begs the question. Lost wages may merely be a yardstick for other damages. *See supra* p. 15 & n.16. An award for an injury to dignitary interests does not constitute back pay. Second, § 104(a)(2) clearly constitutes an exception to the "substitution principle." *See Downey v. Commissioner*, 97 T.C. 150, 164 (1991) (§ 104(a)(2) "allows the exclusion for damages that are a substitute for amounts or items that otherwise would be taxable or would potentially produce taxable benefit, such as income lost as a result of a personal injury"). Even the Commissioner concedes that the exclusion of § 104(a)(2) applies to payments received in lieu of wages by virtue of physical injury. These wages, however, would also have been taxable when earned and would therefore be taxable under the substitution principle.[20]

III. The Commissioner's proposed approach, in which damages attributable to a nonphysical injury are excludable only where they *restore lost capital*, is conceptually misguided, is contrary to the statute, and renders section 104(a)(2) superfluous.

In his attempt to exclude respondents' awards from the scope of § 104(a)(2), the Commissioner introduces the concept that a recovery received on account of a nonphysical injury is excludable from income only if it compensates the taxpayer for

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20. The Commissioner also protests that "tax-free" recoveries constitute an improper windfall where they would otherwise have been taxable. SG Brief at 22 n.16. The Commissioner's argument is not relevant in determining the scope of § 104(a)(2). First, victims of personal injury are accorded the exclusion of § 104(a)(2) because the award, even if proximately measured by back pay or lost wages, are to compensate for a personal injury, an interest for which there is no ready price. *See Pistillo*, 912 F.2d at 150. Second, there is no reason to believe that Congress has not maintained the exclusion out of a sense of compassion for the victims of personal injury. *Roemer*, 716 F.2d at 696 n.2.

a prior loss of "personal capital." SG Brief at 14. Because a damage award measured by back pay purportedly would not constitute such a recovery, the amount would be taxable. *See* SG Brief at 20-21, 26 n.20. This Court should reject the Commissioner's proposed approach.

A. The Commissioner's definition of "personal capital" is conceptually misguided.

The Commissioner concedes that damages received on account of *physical* injuries, even when measured by back pay, constitute a return of personal capital and are not taxable. SG Brief at 21 n.16. The Commissioner then argues that damages received on account of *nonphysical* injuries, when measured in precisely the same fashion, cannot constitute a return of personal capital. SG Brief at 26 n.20. This position is ill-conceived and conceptually misguided. A person's intellect, integrity, self-respect and good name are as much "personal capital" as are arms and legs and good health. All are essential aspects of a human being.[21]

The issue is not whether income can be generated from such personal capital. Nor is the issue whether such income, when generated, can be taxed. The issue is whether damages received from an injury to such personal capital are or should be taxed and, more specifically, in this case, whether such damages should be taxed when the injury was caused by years of invidious discrimination based upon the sex of the injured party.

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21. *See* William Shakespeare, *Othello*, act 3, sc. 3:
Good name in man and woman, dear my lord,
Is the immediate jewel of their souls:
Who steals my purse steals trash; 'tis something, nothing;
'Twas mine, 'tis his, and has been slave to thousands;
But he that filches from me my good name
Robs me of that which not enriches him,
And makes me poor indeed.

It is undisputed that the tax law does not and should not tax the possession or enjoyment of "personal capital" such as good health or a fine intellect. *See Hawkins*, 6 B.T.A. at 1025. The Commissioner's own rulings have long recognized this principle. From 1918 to the present, the IRS has steadfastly maintained that damages received on account of a personal injury should not be taxed because they are a return of personal capital. *See* Sol. Op. 1384, 2 C.B. at 72 (citing 31 Op. Att'y Gen. 304 (1918)); Rev. Rul. 61-1, 1961-1 C.B. 14; Rev. Rul. 85-143, 1985-2 C.B. 55 (citing rulings).

While these rulings have been couched in technical tax terms such as "basis" and "return of capital," as Justice Frankfurter acknowledged in *United States v. Kaiser*, 363 U.S. 299, 311-12 (1960) (Frankfurter, J., concurring), these rules are technically suspect but unquestionably correct:

> The principle at work here [in the Commissioner's holdings in Sol. Op. 1384 and Sol. Op. 132, I-1 C.B. 92 (1922)] is that *payment which compensates for a loss of something which would not itself have been an item of gross income is not a taxable payment.* . . . If a capital asset is sold for no more than its basis there is no taxable gain. The result, then, is the same if it is destroyed and there is paid in compensation no more than its basis. There are, to be sure, difficulties, not present where ordinary assets are involved, in applying this principle to compensation for the loss of something which has no basis and which is not ordinarily thought of as a capital asset, such as health or life or affection or reputation. . . .
>
> [In recoveries for personal injury,] the thing lost and compensated for was not an item of taxable income, but an aspect of capital or analogous to capital, which obviously would not have been included in gross income had it been retained.

Id. (emphasis added).[22]

The Commissioner's rulings cited above are technically questionable because in reality such "personal capital" has no measurable basis. Because "personal capital" has no basis, theoretically any amount received as compensation for its loss is technically "gain." The rulings, however, are also unquestionably correct in excluding such theoretical gain from taxation. They are correct for one simple and overriding reason: Any tax system that reached a different result would be one that placed the technical theory of gain and loss and income above basic concepts of value and human dignity.

B. The Commissioner's proposed test has no basis in the statute.

The Commissioner's "return of capital" theory also suffers from the flaw that it has no basis in the statute. In fact, there is not one shred of evidence in the statute that Congress intended to limit the term "any damages" to awards that constitute a return of capital. Neither the statute itself nor the legislative history refers to such a concept. Moreover, there are substantial reasons to believe that Congress did *not* intend that the courts read a return of capital qualification into § 104(a)(2). Such a reading would render § 104(a)(2) a nullity and introduce a complex and difficult test into tax administration.

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22. Under a traditional application of the return of capital theory, *all* personal injury recoveries (which are by definition compensatory only, *Glenshaw Glass*, 348 U.S. at 432 n.8) do not constitute accessions to wealth. The Commissioner's distinction between "return of capital" and "gain or profit" would therefore have no application for compensatory damages, whether those damages compensated for economic or noneconomic consequences. It is also arguable that, regardless of considerations of tax theory, Congress has accepted the Commissioner's *de facto* exclusion of these items from income through continued congressional acquiescence. *See* Boris I. Bittker & Martin J. McMahon, Jr., *Federal Income Taxation of Individuals* ¶ 3.6, at 3-20 (1988) (arguing for such congressional acquiescence).

C. The Commissioner's argument renders section 104 (a)(2) superfluous.

The Commissioner argues that, for nonphysical injuries, § 104(a)(2) should exclude only those recoveries that represent a "return of capital" to the taxpayer.[23] Acceptance of the Commissioner's "return of capital" argument reads § 104(a)(2) out of the Code. This Court should reject it.

The Commissioner's position could not be more clear. According to his argument, respondents must establish that "the recovery is reimbursement for a prior loss of personal 'capital' . . . and does not represent gain or profit that 'instead add[s] to [their] wealth.' " SG Brief 14-15 (citations omitted). It is equally clear, however, if a taxpayer can establish that a reimbursement is a return of capital, the amount does not constitute income in any event and would not be taxable under the Sixteenth Amendment. 31 Op. Att'y Gen. 304; Sol. Op. 132, I-1 C.B. at 93; *see Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185 (1918) (return of capital not income).

If the amounts received constitute a "return of capital," then under this Court's holding in *Doyle*, the amounts do not constitute income and by definition they are not taxable under the Sixteenth Amendment. The Commissioner, however, would limit the exclusion of § 104(a)(2) to precisely those recoveries. At least with respect to nonphysical injuries, the Commissioner's test would read § 104(a)(2) out of the Code. This Court has long held that an interpretation of a statute that renders the statute a nullity cannot be adopted. *Singer v. United States*, 323 U.S. 338, 344 (1945) (Court avoids interpretation that makes provision redundant); *Bernier v. Bernier*, 147 U.S. 242, 245 (1893) (statutes must be interpreted so that one section "will not defeat or destroy another, but explain and support it").

23. Relying on footnote 8 of *Glenshaw Glass*, the Commissioner argues that the Court "did not reject" his position, taken since 1918, that recoveries for personal injuries do not constitute income to the extent they "correspond to a return of capital." SG Brief at 13.

Because acceptance of the Commissioner's argument would have this precise effect, that construction should be rejected.

D. The Commissioner's test relies on a theory that has no discernable scope.

The Commissioner's test also suffers from the arbitrary distinction between what constitutes a "return of capital" *versus* "gain or profit." The Commissioner argues that recoveries of back wages on account of a physical injury are a return of capital. SG Brief at 21 n.16. But the Commissioner insists that recoveries for back wages on account of a nonphysical injury are not a return of capital. SG Brief at 26 n.20. These two situations, however, are indistinguishable. In both cases the victims are prevented from earning their wages either because (for example) the employer's machinery tortiously injured the employee or because (for example) the employer discriminatorily fired the employee. There is no discernable reason to conclude that human capital includes the ability to obtain an income stream in the former instance and not in the latter. The Commissioner attempts to distinguish the two tort victims by arguing that back wages for nonphysical injuries represent wages that should have been paid but were not. This distinction, however, provides no guidance regarding the contours of "human capital" since both tort victims cannot work and do not receive wages.

Nor do cases or rulings illuminate the inquiry. Because of the novelty of the Commissioner's test, no court has ever examined this issue in determining the scope of § 104(a)(2). In fact, the only guidance available predates *Glenshaw Glass* by at least twenty years. *See McDonald v. Commissioner*, 9 B.T.A. 1340, 1341 (1928) (damages for breach of contract to marry); *Hawkins*, 6 B.T.A. at 1025 (defamation); Sol. Op. 132, I-1 C.B. at 93 (defamation, alienation of affections, surrender of a child); 31 Op. Att'y Gen. 304 (personal injury). The Commissioner's test is unwarranted under the statute and, because of the lack of definiteness of "human capital," injects vast uncertainty into tax administration. This Court should reject it.

IV. Amounts received by respondents in settlement of their Title VII suit are excludable from income under section 104(a)(2).

As discussed *supra* pp. 13-15, the Tax Court and the Courts of Appeals have uniformly based the tax treatment of damages received through suit or settlement on the nature of the claim giving rise to the awards. Because suits brought under Title VII allege a personal injury within the meaning of § 104(a)(2), any damages received through prosecution or settlement of a Title VII action fall squarely within the exclusion. Because the back pay awards received by respondents are "damages received . . . on account of personal injuries" within the meaning of § 104(a)(2), the entire award is excludable from gross income.

A. A violation of Title VII results in "personal injuries" within the meaning of section 104(a)(2).

Although § 104(a)(2) does not define the term "personal injuries," the Tax Court and the Courts of Appeals have consistently interpreted it to have two components. First, to qualify as an injury, the alleged harm must give rise to "some sort of tort claim against the payor." *Glynn v. Commissioner*, 76 T.C. 116, 119 (1981); *see Pistillo*, 912 F.2d at 148; *Rickel*, 900 F.2d at 658. Second, a "personal" injury requires the Court to distinguish between personal and nonpersonal injuries. *Roemer*, 716 F.2d at 697 ("relevant distinction that should be made is between personal and nonpersonal injuries"); *Thompson*, 866 F.2d at 711 (same). An injury to property, for example, would be a "nonpersonal" injury. Because a claim for violation of Title VII meets both requirements, it is a claim on account of "personal injuries" within the meaning of § 104(a)(2).

A claim of employment discrimination implicates a tort or tort-type right in either of two ways. First, it may allege a breach of duty that "arises by operation of law," "independent

of any duty an employer might owe his employee pursuant to an express or implied employment contract." *Byrne v. Commissioner*, 883 F.2d 211, 215 (3d Cir. 1989) (violation of FLSA's duty not to discriminate against whistleblowers); *see Pistillo*, 912 F.2d at 149 (violation of ADEA's duty not to discriminate on the basis of age); *Rickel*, 900 F.2d at 662 (same); *Thompson*, 866 F.2d at 712 ("tort action is one for 'a direct invasion of some legal right of the individual' independent of contract") (quoting Black's Law Dictionary 1335 (5th ed. 1979)). An employment discrimination action also vindicates a tort-type right when it alleges "any invasion of the rights that an individual is granted by virtue of being a person in the sight of the law." *Threlkeld*, 87 T.C. at 1308; *see Bent*, 835 F.2d at 69 (42 U.S.C. § 1983 (1988) violation; invasion of right to freedom of speech); *Wulf*, 883 F.2d at 873 (same).

An action based on Title VII falls squarely within either definition. A claim under Title VII seeks to remedy an alleged violation of the employer's statutory duty not to discriminate on the basis of race, color, religion, sex or national origin, a duty independent of any contractual duty an employer might owe its employees. 42 U.S.C. § 2000e-2 (1988); *Thompson*, 866 F.2d at 712 ("right to be free from unreasonable gender discrimination is a personal right" independent of contract). Similarly, it has long been held that discrimination on the basis of sex, race, or national origin results in an invasion of the individual rights and dignity of the person. *See, e.g., Goodman v. Lukens Steel Co.*, 482 U.S. 656, 661 (1987) (race discrimination, challenged under 42 U.S.C. § 1981 (1988), "is a fundamental injury to the individual rights of a person"); *Curtis v. Loether*, 415 U.S. 189, 195 n.10 (1974) (analogizing race discrimination to a "dignitary tort"); *Price Waterhouse v. Hopkins*, 490 U.S. 228, 264 (1989) (O'Connor, J., concurring) (violation of Title VII, "the statutory employment 'tort,' " similar to common law tort). Respondents' Title VII claim alleging unlawful gender discrimination, therefore, seeks vindication of tort-type rights.

A violation of Title VII also results in an injury to the person of the claimant. Courts have frequently noted the physical and psychological injuries resulting from workplace dis-

crimination on the basis of sex, race or national origin. *See, e.g., Zabkowicz v. West Bend Co.*, 789 F.2d 540, 542 (7th Cir. 1986) (doctor's diagnosis of " 'gastro-intestinal disease due to [sexual] harassment at work' "); *Brooms v. Regal Tube Co.*, 881 F.2d 412, 417 (7th Cir. 1989) (severe, debilitating depression caused by sexual and racially motivated harassment in workplace). Congress, too, has recognized that personal injuries result from workplace discrimination:

> Victims of *intentional* discrimination often endure terrible humiliation, pain and suffering while on the job. This distress often manifests itself in emotional disorders and medical problems, which in turn cause victims of discrimination to suffer substantial out-of-pocket medical expenses and other economic losses as a result of the discrimination . . . . The Committee intends to confirm that the principle of anti-discrimination is as important as the principle that prohibits assaults, batteries and other intentional injuries to people.

H.R. Rep. No. 40, 102d Cong., 1st Sess., pt. 1 at 14-15 (1991) (emphasis in original). These injuries to the person of the victim are clearly distinct from nonpersonal injuries to the victim's property rights or contract rights. They also are distinct from the nonpersonal consequences of the injury, such as loss of income. Because a suit brought under Title VII seeks to vindicate tort-type rights, the violation of which causes physical and psychological harm to the claimant, respondents' claims of gender discrimination under Title VII are "personal injuries" within the meaning of § 104(a)(2).[24]

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24. Recently, in *Owens v. Okure*, 488 U.S. 235 (1989), this Court held that the general limitations statute for personal injury actions applies to claims brought under 42 U.S.C. § 1983, including a claim for gender discrimination under the Equal Protection Clause. In so holding, this Court stated that § 1983 " 'confer[s] a general remedy for injuries to personal rights' " and that " '§ 1983 claims are best characterized as personal injury actions.' " *Id.* at 240 (citations omitted). *See Goodman v. Lukens Steel Co.*, 482 U.S. 656 (1987) (a violation of § 1981 is a "tort-type" injury for purposes of determining which (continued...)

B. Title VII back pay awards are damages within the meaning of section 104(a)(2).

Section 104(a)(2) excludes "any damages" from gross income. The regulations specify that "[t]he term 'damages received' " means "an amount received . . . through prosecution of a legal suit or action based upon tort or tort-type rights, or through a settlement agreement." Treas. Reg. § 1.104-1(c).

One court has held that an award of back pay received through the prosecution of a Title VII action, being an equitable remedy, is not "damages" within the meaning of § 104(a)(2). *Sparrow v. Commissioner*, 1991 U.S. App. LEXIS 27991 (D.C. Cir. Nov. 26, 1991). In construing § 104(a)(2), however, the Commissioner's regulations define the term "damages" to include "*an* amount" received on account of personal injuries, apparently eliminating any distinction between damages in equity and at law.[25] Treas. Reg. § 1.104-1(c) (emphasis added). The plain meaning of the term "damages" also does not support a distinction between legal and equitable relief. *See* Black's Law Dictionary 351 (5th ed. 1979) ("a pecuniary compensation . . . which may be recovered in the courts"). The structure of § 104(a) also belies any distinction between equitable and legal damages. Excludability turns on the source of the amounts received, not their nature. *See* I.R.C. § 104(a)(1) ("amounts received under workmen's compensation"); *id.* at § 104(a)(3) ("amounts received through accident or health insurance"); *id.* at § 104(a)(4) ("amounts received as a pension [or] annuity"); *id.* at § 104(a)(5) ("amounts received . . . as disability income").

24.(...continued)
state statute of limitations applies). Similarly, Title VII claims seek relief for injuries resulting from discrimination -- personal injuries for purposes of § 104(a)(2). *Metzger*, 88 T.C. 834 (claims under §§ 1981 and 1983 and Title VII are actions for a personal injury).

25. This issue is discussed at greater length in respondents' brief.

Other provisions of the Code explicitly refer to equitable and legal actions when appropriate. *See, e.g.*, I.R.C. § 6305(b) (1989) (removing from jurisdiction of United States courts "any action, whether legal or equitable" brought to review certain tax collections). Absent any evidence to the contrary, the plain meaning of the term "damages" should prevail and, therefore, § 104(a)(2) applies to back pay awards under Title VII despite their equitable nature. *Escondido Mutual Water Co. v. LaJolla Band of Mission Indians*, 466 U.S. 765, 772 (1984) ("[s]ince it should be generally assumed that Congress expresses its purposes through the ordinary meaning of the words it uses, we have often stated that '[a]bsent a clearly expressed legislative intention to the contrary, [statutory] language must ordinarily be regarded as conclusive' ") (citations omitted).

CONCLUSION

The opinion of the Sixth Circuit Court of Appeals should be affirmed.

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IN THE
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OCTOBER TERM, 1991

UNITED STATES OF AMERICA,
Petitioner,
v.
THERESE A. BURKE, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF *AMICUS CURIAE* OF THE EQUAL EMPLOYMENT ADVISORY COUNCIL IN SUPPORT OF THE RESPONDENTS

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IN THE

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THERESE A. BURKE, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF *AMICUS CURIAE* OF THE EQUAL EMPLOYMENT ADVISORY COUNCIL IN SUPPORT OF THE RESPONDENTS

The Equal Employment Advisory Council (EEAC) respectfully submits this brief *amicus curiae* in support of the respondent pursuant to Supreme Court Rule 37. Letters of consent of the Solicitor General and the respondent have been filed with the Clerk of the Court.

INTEREST OF THE *AMICUS CURIAE*

EEAC is a nationwide association of employers and trade associations, organized in 1976 to promote sound approaches to the elimination of employment discrimination. Its membership includes over 250

major U.S. companies, as well as several associations which themselves have hundreds of corporate members. The Council's governing body is a Board of Directors composed of experts in the field of equal employment opportunity. Their combined experience gives EEAC an unmatched depth of knowledge of the practical as well as the legal aspects of equal employment policies and requirements. The members of EEAC are firmly committed to the principles of nondiscrimination and equal employment opportunity.

As employers, EEAC's members are subject to various equal employment laws, including Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e *et seq.*, the Age Discrimination in Employment Act of 1967 (ADEA), *as amended*, 29 U.S.C. § 621 *et seq.*, 42 U.S.C. § 1981, Executive Order 11,246 (30 Fed. Reg. 12,319 (1965), *as amended by* 32 Fed. Reg. 14,302 (1967)), and other federal, state and local statutes, orders and regulations prohibiting employment discrimination. As respondents in discrimination proceedings, many of EEAC's members will be involved in monetary settlements and remedial orders involving employment discrimination claims, charges and lawsuits.

Thus, EEAC's members have a direct interest in the issue presented here: whether payments received by an individual in settlement of a Title VII claim are excludable from the individual's gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received . . . on account of personal injuries." Indeed, the potential impact of this case extends beyond Title VII. The Solicitor General's petition "agree[s] with the court of appeals that there is no valid basis for distinguishing the tax

treatment of back pay under Title VII and under the ADEA." Pet. at 17.[1]

The Court's decision will have a direct and substantial impact on the ability of parties to settle employment discrimination claims, as the degree of tax liability has an absolute bearing on the amount of settlement or monetary relief that an individual will take home after tax liability has been calculated. Moreover, to the extent that the government now is refusing to settle employment discrimination cases unless taxes are deducted from the settlement amount, there is a disparity in settlement practices between cases involving the government and those settled by private entities.

The issues presented here require comparisons between the antidiscrimination and remedial schemes of the various statutes at issue in this case, and in other cases involving settlement of such claims. EEAC has been involved as *amicus curiae* in numerous cases involving those statutes. *See, e.g., Goodman v. Lukens Steel Co.*, 482 U.S. 656 (1987) (state *tort* statute of limitations applies to claims under 42 U.S.C. § 1981); *Lytle v. Household Mfg., Inc.*, 110 S. Ct. 1331 (1990) (court's Title VII determination did not stop right to Section 1981 jury trial on same issue); *Patterson v. McLean Credit Corp.*, 109 S. Ct. 2363 (1989); *Price Waterhouse v. Hopkins*, 109 S. Ct. 1775 (1989); *Evans v. Jeff D.*, 475 U.S. 717 (1986); *International Bhd. of Teamsters v. United States*, 431 U.S. 324 (1977); *Delta Air Lines v. August*, 450 U.S. 346 (1981) (Rule 68); *Marek v. Chesney*, 473 U.S. 1 (1985) (Rule 68); *Great Am. Fed. Sav. & Loan*

[1] "Pet." references are to the petition for a writ of certiorari filed by the Solicitor General in this Case.

Ass'n v. Novotny, 442 U.S. 366 (1979) (comparison of Title VII and 42 U.S.C. § 1985(3); *General Bldg. Contractors Ass'n v. Pennsylvania*, 458 U.S. 375 (1982) (Section 1981 requires proof of intentional discrimination); *United States v. East Tex. Motor Freight Sys.*, 564 F.2d 179 (5th Cir. 1977) (applied Title VII seniority standards to Executive Order 11246); and *United States v. Trucking Management, Inc.*, 662 F.2d 36 (D.C. Cir. 1981) (same).

Accordingly, because of its past experience with these issues, EEAC is well qualified to brief the Court in this case. EEAC's brief will be directed toward arguing that Title VII claims are personal injury claims, thus falling within the Section 104(a)(2) exemption. *Cf. Goodman v. Lukens Steel Co.*, 482 U.S. 656 (1987).

STATEMENT OF THE CASE

This case involves the issue of whether monetary amounts received in settlement of a Title VII sex discrimination action are excludable from taxable income. Section 104(a)(2) of the Internal Revenue Code provides:

> (a) *In general.*—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, *gross income does not include*— . . .
>
> (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of *personal injuries* or sickness . . .

26 U.S.C. § 104(a)(2) (emphasis added).

The taxpayers herein brought this action seeking refunds of federal income and social security taxes

withheld from payments received from their employer in settlement of a Title VII sex discrimination action. The Sixth Circuit examined "the nature of the injury to determine whether the injury and claim are tort-like in nature, and not whether the consequences of the injury resulted in an award of compensatory damages or damages for back pay." *Burke v. United States*, 929 F.2d 1119, 1121 (6th Cir. 1991), *cert. granted*, No. 91-42.

The Sixth Circuit held that the monetary settlement here was for "personal injury" and thus exempt from taxation under Section 104(a)(2). The court stated that:

> "[c]ourts have long held that injuries resulting from invidious discrimination, be it on the basis of race, sex, national origin or some other unlawful category, are injuries to the individual rights and dignity of the person. *See, e.g., Goodman v. Lukens Steel Co.*, 482 U.S. 656, 661 (1986) (race discrimination, challenged under § 1981, is a fundamental injury to the individual rights of the person; *cf. Wilson v. Garcia*, 471 U.S. 261, 277 (1985) (analogizing a violation of the Civil Rights Acts of 1871 to a violation of the fourteenth amendment which sounds in tort as an injury to the person); *Curtis v. Loether*, 415 U.S. 189, 195-96 n. 10 (1974) (analogizing racial discrimination to a "dignitary tort."). This long-held view of the tort-like nature of the injury resulting from unlawful discrimination has led this court and others to the conclusion that damages resulting from an action for unlawful discrimination are "damages on account of personal injury" for the purposes of § 104(a)(2).

929 F.2d at 1121-22. (citations omitted) Based on this reasoning, the Sixth Circuit held that the with-

holding of federal taxes from the Title VII settlement damages giving rise to this taxpayer action was improper. 929 F.2d at 1124.

This *amicus curiae* brief addresses in more detail the case and statutory authority holding that the personal injury nature of claims brought under 42 U.S.C. §§ 1981 and 1983 is equally applicable to Title VII claims.

SUMMARY OF ARGUMENT

The court below correctly ruled that monetary settlements of Title VII claims are "on account of personal injuries" and thus exempt from taxation under the exemption found in Section 104(a)(2) of the Internal Revenue Code. Numerous courts have agreed that this exemption does not lose its force even if the injury involves back pay, as the nature of the injury is tort-like in nature, whatever the form of injury resulting from alleged violation.

This Court repeatedly has held that the rights protected by the civil rights statutes are personal in nature. For example, *Wilson v. Garcia*, 471 U.S. 261 (1985) and *Goodman v. Lukens Steel Co.*, 471 U.S. 261 (1987) held that state tort statutes of limitations apply to suits brought under 42 U.S.C. §§ 1981 and 1983. The Court rejected assertions that discrimination claims essentially are contractual in nature, and instead found that these statutes protect against conduct that involves "a fundamental injury to the individual rights of a person." *Lukens Steel*, 482 U.S. at 661-62. Likewise, Title VII involves a statutory employment "tort" that is "contrary to public policy and harmful to society as a whole." *Price*

Waterhouse v. Hopkins, 109 S. Ct. 1775, 1798 (1989) (O'Connor, J., concurring).

Universally, court decisions have construed Title VII and Section 1981 as providing identical causes of actions on issues where their substantive provisions both apply. Indeed, in its *amicus curiae* brief in *Johnson v. Railway Express Agency Inc.*, the Solicitor General argued that "claims of racially discriminatory employment practices under Section 1981 and Title VII are essentially equivalent in substance." Brief at 21. Thus, the government's unexplained assertions that *Lukens Steel* and *Wilson* "shed[] no light" on the issues in the instant case (Brief of the United States at 29) need be given no weight.

In *Patterson v. McLean Credit*, 109 S. Ct. 2363, 2377-78, 2393, both the majority and dissenting opinions stated that Title VII's burden of proof scheme should be used to examine the Section 1981 promotion discrimination issue before the Court. In addition, a large body of lower court opinions has ruled consistently that the causes of action under Title VII and Sections 1981 and 1983 are virtually identical. Indeed, it is quite common for plaintiffs to challenge the same practices under both Section 1981 and Title VII and for these issues to be treated as identical by the courts.

Moreover, the courts universally have rejected arguments that Section 1981 affords more protections than Title VII because Section 1981 does not have Title VII's specific limitations, such as requiring a showing of intentional discrimination to attack an otherwise bona fide seniority system.

Given the identical "personal" nature of claims under Title VII and Section 1981, the Court should

affirm the Sixth Circuit's reliance on *Wilson* and *Lukens Steel* as a basis for ruling that monetary amounts received under Title VII are "damages on account of personal injury" for the purposes of § 104(a)(2)'s exemption from personal income taxes.

ARGUMENT

THE COURT OF APPEALS CORRECTLY RULED THAT TITLE VII CLAIMS ARE FOR PERSONAL INJURIES AND THUS MONETARY SETTLEMENTS FOR SUCH CLAIMS ARE EXEMPT FROM TAXATION UNDER THE EXEMPTION FOUND IN SECTION 104(a)(2) OF THE INTERNAL REVENUE CODE

A. This Court's Decisions in *Lukens Steel* and *Wilson* Held That Civil Rights Statutes (Sections 1981 and 1983) Protect Personal Injuries That Are Characterized as Statutory Torts

The Sixth Circuit's decision below and other decisions have relied upon this Court's decisions in *Goodman v. Lukens Steel Co.*, 482 U.S. 656 (1987), and *Wilson v. Garcia*, 471 U.S. 261 (1985), in holding that Title VII and ADEA claims are exempt from federal income taxes.[2] For the reasons set forth below, the government is plainly incorrect in its unexplained assertion that these decisions "shed[] no light on the proper interpretation of Section 104(a)(2) of the Internal Revenue Code." (Brief for the United States at 29.) *Wilson*, *Lukens Steel* and other related decisions provide direct support for the Sixth Circuit's holding that Title VII monetary settlements are exempt as amounts of damages received "on account of personal injuries" under Section 104(a)(2).

[2] *See e.g.*, *Rickel v. Commissioner*, 900 F.2d 655, 662-63 (3rd Cir. 1990) (ADEA); *Pistillo v. Commissioner*, 912 F.2d 145, 149 (6th Cir. 1990) (ADEA).

Prevailing decisions have established that violations of federal statutory rights are "a personal injury tort or tort type right, rather than for an economic right arising out of contract." *Byrne v. Commissioner*, 883 F.2d 211, 215 (3d Cir. 1989).

> Lawsuits brought under these statutes allege violations of a duty owed the plaintiff by the defendant employer that arises by operation of the Act. This duty is independent of any duty an employer might owe his employee pursuant to an express or implied employment contract; it arises by operation of law.

Id. at 215.

Both *Wilson* and *Lukens Steel* held that the statute of limitations for personal injury claims should be used for suits under both 42 U.S.C. §§ 1981 and 1983. *Wilson v. Garcia* involved 42 U.S.C. § 1983. Section 1983 provides a federal remedy for violation of constitutional rights. The Court held that these claims were "more analogous to tort claims for personal injury than, for example, to claims for damages to property or breach of contract." 471 U.S. at 277. After stressing that the Constitution protects the rights of "*persons*," the Court concluded that "[a] violation of that command is an injury to the individual rights of the person." *Id.* The Court in *Wilson* also explained that characterizing all § 1983 actions as involving "personal injuries minimizes the risk that the choice of a state statute of limitations would not fairly serve the federal interests vindicated by § 1983." *Id.* at 279.

Similarly, the Court extended this ruling to suits brought under 42 U.S.C. § 1981 and held that Section 1981 involves claims of "personal injury." *See Good-*

man v. Lukens Steel, 482 U.S. 656. *Lukens Steel* is of particular relevance here because the plaintiff apparently brought the same racial discrimination claims under *both* Title VII and 42 U.S.C. § 1981. Some of the Title VII claims involved "disparate impact," which cannot be brought under § 1981. But as to claims of "disparate treatment" (i.e., intentional) discrimination:

> The District Court proceeded to find that the company had violated Title VII in several significant respects, including the discharge of employees during their probationary period, the toleration of racial harassment by employees, initial job assignments, promotions and decisions on incentive pay. The court also found that *in these identical ways the company had also violated § 1981* . . .
>
> Similarly, the Unions were found to have discriminated on racial grounds *in violation of both Title VII and § 1981 in certain ways*: failing to challenge discriminatory discharges of probationary employees; failure and refusal to assert racial discrimination as a ground for grievances; and toleration and tacit encouragement of racial discrimination.

482 U.S. at 664-65 (emphasis added). Thus, the substantive § 1981 and Title VII issues were seen to be identical.[3]

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[3] As argued more fully below, the overwhelming weight of authority recognizes that the same substantive standards apply to disparate treatment suits brought under Title VII and § 1981. Indeed, "[i]t is quite common for an employment discrimination plaintiff to bring his action under both § 1981 and Title VII." Comment, *Arbitral Deference and the Right to Make and Enforce Contracts under 42 U.S.C. § 1981*, 82 Nw. U.L. Rev. 109, 112 (1987).

On the limitations period issue, even though Section 1981, by its terms, is premised upon the denial of the right "to make and enforce contracts" as is enjoyed by white citizens, the Court rejected the argument that Section 1981 claims are essentially contractual" and not personal. Despite Section 1981's reference to contract rights, the court declined to apply the longer limitations period applicable to contract claims:

> Section 1981 has a much broader focus than contractual rights. . . . Its heading was and is "Equal rights under the law" and is contained in a chapter entitled "Civil Rights." Insofar as it deals with contracts, it declares the personal right to make and enforce contracts, a right, as the section has been construed, that may not be interfered with on racial grounds. The provision asserts, in effect, that competence and capacity to contract shall not depend upon race. *It is thus part of a federal law barring racial discrimination, which, as the Court of Appeals said, is a fundamental injury to the individual rights of a person.* . . . That § 1981 has far-reaching economic consequences does not change this conclusion, since the impact flows from guaranteeing the personal right to engage in economically significant activity free from racially discriminatory interference. The Court of Appeals was correct in selecting the Pennsylvania 2-year limitations period governing personal injury actions.

482 U.S. at 661-62 (emphasis added).[4]

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[4] With respect to Title VIII of the Civil Rights Act of 1968, 42 U.S.C. § 3612, Justice Marshall's unanimous decision stated:

> An action to redress racial discrimination may also be likened to an action for defamation or intentional inflic-

The same reasoning applies equally to claims brought under Title VII. As Justice O'Connor has explained: "[l]ike the common law of torts," the statutory employment "tort" created by Title VII has the purposes of "deter[ring] conduct which has been identified as contrary to public policy and harmful to society as a whole," and making whole the victims of employment discrimination. *Price Waterhouse v. Hopkins*, 109 S. Ct. 1775, 1798 (1989) (O'Connor, J., concurring).

Thus, insofar as Title VII and Sections 1981 and 1983 provide causes of action for personal injury, monetary remedies under all those statutes should be exempt under Section 104(a)(2) of the Internal Revenue Code.

Indeed, as we now show, this and other courts have recognized that the substantive discrimination claims under Title VII are of the same personal nature as employment discrimination claims brought under 42 U.S.C. §§ 1981 and 1983. Both involve a duty owed by the employer to employees that "is independent of any duty an employer might owe his employee pursuant to an express or implied employment contract; it arises by operation of law." *Byrne v. Commissioner*, 883 F.2d 211, 215 (3d Cir. 1989).[5]

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tion of emotional distress. Indeed, the contours of the latter tort are still developing, and it has been suggested that "under the logic of the common law development of a law of insult and indignity, racial discrimination may be treated as a dignitary tort."

Curtis v. Loether, 415 U.S. 189, 195 n.9 (1974) (citation omitted). *See also Davis v. Passman*, 442 U.S. 228, 235 n.10 (1979) (the right to be free from unreasonable gender discrimination is a personal right).

[5] The Solicitor General argues that "the existence of the respondents' employment contracts underlies their claims for wages", in that their claim for lost wages is based on "a condition of that contract implied in law." Brief for the United States at 23. The government's position here is a replay of the contract-based arguments rejected in *Lukens Steel*, where the cause of action was held to involve claims for personal injury notwithstanding the fact that the denial of the right to contract is the gravamen of a Section 1981 claim.

Additionally, even if the monetary claims here involve back pay—a point disputed by the respondent—several courts have ruled, that "to determine whether damages received by a taxpayer were paid on account of personal injuries, courts must look to the *nature of the claim* and not to the consequences that result from the injury." *Pistillo v. Commissioner*, 912 F.2d at 148-49, and cases cited. As the court below correctly stated, it is the nature of the injury and not "whether the consequences of the injury resulted in an award of . . . damages for back pay" which is determinative. *Burke v. United States*, 929 F.2d at 1121.

B. Like Sections 1981 and 1983, Title VII Claims Involve Personal Injury Actions Exempt From the I.R.C.

There can be no serious argument that the substantive protections of Title VII and 42 U.S.C. § 1981 are not of the same personal nature. Thus, the government cannot brush off *Lukens Steel* as "shed[ing] no light" on this case. *See* Brief for the United States at 29.

Indeed, the government's argument here is undercut by its argument in *Johnson v. Railway Express Agency, Inc.*, 421 U.S. 454 (1975). In *Johnson*, the Solicitor General explained the relationship between Title VII and Section 1981:

> Title VII offers the aggrieved individual special assistance—e.g., investigations, conciliation machinery, legal counsel, waiver of court costs, and attorneys' fees—unavailable under Section 1981. But for individuals alleging that employers covered by Title VII have discriminated against

> them on the basis of race, *the substantive protections of the two statutes are quite similar.*

Brief for the United States as *Amicus Curiae*, in *Johnson v. Railway Express Agency, Inc.*, *supra*, at 13 (emphasis added). The government's *Johnson* brief further explained: "As we have shown above, . . . claims of racially discriminatory employment practices under Section 1981 and Title VII *are essentially equivalent in substance.*" *Id.* at 21.

That position has been adopted universally by the courts, and both this Court and the Solicitor General have determined that Section 1981 will be enforced by applying Title VII's burden of proof scheme established in *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973), and related cases. For example, in *Patterson v. McLean Credit Union*, 109 S. Ct. 2363, 2377-78 (1989)—a suit brought under Section 1981—the majority opinion stated:

> We have developed, *in analogous areas of civil rights law*, in a carefully designed framework of proof to determine, in the context of disparate treatment, the ultimate issue of whether the defendant intentionally discriminated against the plaintiff. See *Texas Dept. of Community Affairs v. Burdine*, 450 U.S. 248 (1981); *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973). We agree with the Court of Appeals that this scheme of proof, structured as a "sensible, orderly way to evaluate the evidence as it bears on the critical question of discrimination." *Furnco Construction Corp. v. Waters*, 438 U.S. 567 (1978), *should apply to claims of racial discrimination under § 1981.*[6]

[6] On this point, the majority opinion agreed with the Brief for the United States in *Patterson v. McLean Credit Union.* There, the Solicitor General cited *Lukens Steel* to show that proof of discriminatory purpose is required under Section 1981. The brief then argued that "[a]s in actions under Title VII," the same burden of proof scheme should be used for Section 1981 suits. Br. for the United States at 23-24 in *Patterson v. McLean Credit Union*, 109 S. Ct. 2363 (1989).

Similarly, Justice Brennan's dissenting opinion in *Patterson* applied this same line of Title VII precedent in determining that the district court's jury instruction on the plaintiff's promotion claim was "inconsistent with the scheme of proof we have carefully designed in analogous [Title VII] cases" for deciding whether the defendant had committed intentional discrimination. 109 S. Ct. at 2393. As Justice Brennan stated:

> *There is no reason why this scheme of proof*, carefully structured as a "sensible, orderly way to evaluate the evidence in light of common experience as it bears on the critical question of discrimination," *Furnco Construction Corp. v. Waters*, 438 U.S. 567, 577 (1978), *should not apply to claims of racial discrimination under § 1981. Indeed, the Court of Appeals held below that "[t]he disparate treatment proof scheme developed for Title VII actions in McDonnell Douglas Corp. v. Green and its progeny may properly be transposed as here, to the jury trial of a § 1981 claim.*"

109 S. Ct. at 2393 (emphasis added). The dissenting opinion then applied these Title VII standards to determine that the majority had improperly upheld the jury instruction.[7]

[7] *See also New York Transit Auth. v. Beazer*, 440 U.S. 568, 583 n.24 (1979) ("Moreover, our treatment of the Title VII claim also disposes of the § 1981 claim without need of a remand.").

Like this Court, numerous courts have ruled that the causes of action for employment discrimination in Title VII and Sections 1981 and 1983 are virtually identical. *See e.g., Gairola v. Department of Gen. Servs.*, 753 F.2d 1281, 1285 (4th Cir. 1985) ("Under Title VII and either § 1981 or § 1983, the elements of the required prima facie case are the same), and cases cited; *Lewis* v. *University of Pittsburgh*, 725 F.2d 910, 915 (3d Cir. 1983) (§§ 1981 and 1983 claims "require the same elements of proof as a Title VII action"), *cert. denied*, 469 U.S. 892 (1984); *Huebschen v. Department of Health & Social Servs.*, 716 F.2d 1167, 1170 (7th Cir. 1983), *quoting Rivera v. City of Wichita Falls*, 665 F.2d 531, 534 n.4 (5th Cir. 1982) ("when § 1983 is used as a parallel remedy with Title VII in a discrimination suit, the elements of the substantive cause of action are the same under both statutes.").[8] And as noted previously, plaintiffs commonly allege that the same conduct constitutes violations of both Title VII and § 1981.[9]

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[8] Numerous other appellate cases hold that when "the plaintiff predicates liability under Title VII under disparate treatment, the legal elements of the claim are identical to those of a claim under § 1981." *Lincoln v. Board of Regents of the Univ. Sys. of Ga.*, 697 F.2d 928, 935 n.6 (11th Cir. 1983), *cert. denied*, 464 U.S. 826 (1983), and cases cited. *Accord Lewis v. Central Piedmont Community College*, 689 F.2d 1207, 1209 n.3 (4th Cir. 1982), *cert. denied*, 460 U.S. 1040 (1983), and cases cited; *Whiting v. Jackson State Univ.*, 616 F.2d 116, 121 (5th Cir. 1980) ("When section 1981 is used as a parallel basis for relief with section 706 of Title VII against disparate treatment in employment, its elements appear *to be identical to those of section 706.*").

[9] "Disregarding questions of scope and of coverage, jurisdiction, and procedure . . . proof considerations—including burdens of proof, the elements of a prima facie case, and the theories of discrimination—have traditionally been treated as

C. Potential Substantive Conflicts Between Title VII and Section 1981 Have Been Resolved in Favor of the Substantive Requirements and Protections of Title VII

The decisions previously discussed involved claims of disparate treatment where there was no serious dispute that the same substantive standards applied to Title VII and Section 1981 disparate treatment claims. Of particular relevance, in addition, are cases where plaintiffs seized upon language differences between the two statutes to argue that Section 1981 provides more substantive protections than Title VII.

There have been several instances in which asserted substantive conflicts with Title VII have been rejected and Title VII's provisions consistently have been found controlling. Courts thus have been reluctant to find violations under Section 1981 that would invalidate employer practices found permissible under Title VII.

The legislative enactments of Congress "have long evinced a general intent to accord *parallel* or overlapping remedies against discrimination." *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 47 & n.7 (1974) (emphasis added), specifically citing to 42 U.S.C. § 1981.[10] Thus, while it is true that courts have found that Section 1981 was not preempted by

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similar whether an action is brought under Title VII or under one of the earlier civil rights acts. This is true in both the individual case and other class action." Reiss, *Requiem for an "Independent Remedy": The Civil Rights Acts of 1866 and 1817 as Remedies for Employment Discrimination*, 50 S. Cal. L. Rev. 961, 1017 (1977).

[10] *Accord Brady v. Bristol-Meyers, Inc.*, 459 F.2d 621, 623-24 (8th Cir. 1972).

Title VII,[11] such decisions usually have stressed that, unlike here, there was no "specific area of irreconcilable conflict between the laws" presented in those cases.[12] Accordingly, the decisional law demonstrates that the standard of a claim against a private party under 42 U.S.C. § 1981 is in essence that applied in a suit under Title VII, and that "decisions under Title VII cases . . . apply equally to actions brought under the century old Civil Rights Acts, 42 U.S.C. §§ 1981 and 1983." *Shield Club v. City of Cleveland*, 13 Fair Empl. Prac. Cas. (BNA) 533 (N.D. Ohio 1974).[13]

In particular, the courts rejected arguments that the special protections given bona fide seniority systems by Section 703(h) of Title VII did not exist under Section 1981 because similar language was missing from the latter statute.[14] In *Waters v. Wisconsin Steel Works*, 502 F.2d 1309 (7th Cir. 1974), *cert. denied*, 425 U.S. 997 (1976), the plaintiff challenged the employer's "last hired, first fired" seniority system for brick layers. The district court held that the seniority system, which had its genesis in a period of racial discrimination, violated Section 1981 and was not *bona fide* under Title VII. 502 F.2d at 1314, 1317. Although the Seventh Circuit agreed that the employer had violated Section 1981 by its pre-Title VII hiring discrimination, it reversed the district court's holding that the seniority system was invalid because it perpetuated the effects of past discrimination.

The court's rejection of the seniority allegation was based upon Section 703(h) of Title VII and its legislative history. 502 F.2d at 1317-20. In its holding, the court discussed the relationship between the two statutes:

> Title VII and section 1981 are "parallel or overlapping remedies against discrimination." *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 94 S. Ct. 1011, 39 L. Ed. 2d 147 (1974). Consequently, in fashioning a substantive body of law under Section 1981 the courts should, in an effort to avoid undesirable substantive law conflicts, look to the principles of law created under Title VII for direction.

502 F.2d at 1316. The court then stated that "[h]aving passed scrutiny under the substantive require-

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[11] *See, e.g., Sanders v. Dobbs House, Inc.*, 431 F.2d 1097, 1100-01 (5th Cir. 1970) *reh. denied*, 431 F.2d 1097, *cert. denied*, 401 U.S. 948 (1971); and *Johnson v. City of Cincinnati*, 450 F.2d 796, 797-99 (6th Cir. 1971).

[12] *See Sanders*, and *Johnson*, *supra* note 11.

[13] See also *Terrell v. United States Pipe & Foundry Co.*, 6 Fair Empl. Prac. Cas. (BNA) 1027, 1028 (N.D. Ala. 1973) (Title VII definitions used as a guide to determine the proper parties in action under Section 1981); *Espinoza v. Farah Mfg. Co.*, 11 Fair Empl. Prac. Cas. (BNA) 696 (W.D. Tex. 1975) (Section 1981 claim dismissed because Title VII holdings on same subject matter found no violation); *Patterson v. American Tobacco Co.*, 535 F.2d, 257, 270 (4th Cir. 1976) (in order to avoid conflict with Title VII, "bumping" remedy was held not available under Section 1981), *cert. denied*, 429 U.S. 920 (1976).

[14] § 703(h) reads in pertinent part:

> Notwithstanding any other provisions of this title, it shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a bona fide seniority or merit system, provided that such differences are not the result of an intention to discriminate because of race, color, religion, sex, or national origin.

ments of Title VII, the employment seniority system utilized by Wisconsin Steel is not violative of 42 U.S.C. § 1981." 502 F.2d at 1320 n.4.

Similarly, in *Hinton v. Lee Way Motor Freight, Inc.*, 412 F. Supp. 625, 628-29 (W.D. Okla. 1975), the court rejected claims that Lee Way had violated 42 U.S.C. § 1981 by its contractual seniority system. Even though no Title VII allegations were asserted, and the suit was brought *exclusively* under Section 1981, the court applied the seniority protections of Title VII in dismissing the suit, noting that Title VII provided "modern legislative history which is directly in point." *Id.* at 628. After quoting the language in the *Waters* decision, cited above, the court then noted:

> The above statement appears appropriate for consideration in the instant case wherein Plaintiffs proceed only under 42 U.S.C. § 1981, possibly attempting to avoid the congressional dictates of Title VII. *Courts must apply all principles of law applicable to a given issue and may not narrowly construe a particular statute to the exclusion of an overlapping statute on the same issue.* The principles contained in Title VII are applicable to Plaintiff's case herein and are considered by the Court in deciding same.

412 F. Supp. at 628 (emphasis added). *Accord Chance v. Board of Examiners*, 534 F.2d 993 (2d Cir. 1976), *mod. on other grounds*, 534 F.2d 1007 (2d Cir. 1976), *cert. denied*, 431 U.S. 965 (1977), *reh'g denied*, 434 U.S. 881 (1977); *Patterson v. American Tobacco Co.*, *supra* at 270; *cf. Driscoll v. Jefferson*, 11 Fair Empl. Prac. Cas. (BNA) 308 (E.D. Mich. 1975) (oral opinion).

Accordingly, the cases appear to be unanimous that, with respect to Section 1981, the substantive requirements of that earlier legislation must be construed to harmonize with Title VII definitions of discrimination, even where protective language (such as Section 703(h)) has not specifically been provided. In order to avoid conflict in the interpretation of "parallel" federal legislation, Title VII has been interpreted to be the latest and paramount expression of Congressional intent.[15]

The courts thus have realized that to apply different standards under Title VII and Section 1981 "would make little sense." *Setser v. Novak Investment Company*, 657 F.2d 962, 967 (8th Cir. 1981), *cert. denied*, 454 U.S. 1064 (1981). The courts should "look to the principles of law created under Title VII for direction" in order to avoid substantive conflicts with Section 1981. *Id.*, at 967.

Given the overwhelming weight of authority equating the substantive provisions of Title VII and Section 1981, Title VII violations should be construed as causing "a fundamental injury to the individual

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[15] Relying on these decisions, other courts ruled that Title VII's substantive protections of bona fide seniority systems also apply to Executive Order 11,246, another nondiscrimination scheme that does not have the specific seniority protections of Section 703(h) of Title VII. *See United States v. Trucking Management, Inc.*, 662 F.2d 36 (D.C. Cir. 1981); and *United States v. East Tex. Motor Freight Sys.*, 564 F.2d 179, 185 (5th Cir. 1977). In *East Texas* the court relied in part on this Court's remand of the Section 1981 claims in *Sabala v. Western Gillette, Inc.*, 516 F.2d 1251 (5th Cir. 1975), *cert. granted, decision vacated, and case remanded*, 431 U.S. 951 (1977), for reconsideration in light of the Title VII seniority holdings in *International Bhd. of Teamsters v. United States*, 431 U.S. 324 (1977).

rights of a person. . . ." *Goodman v. Lukens Steel*, 482 U.S. at 661-62. Title VII monetary settlements thus are exempt from taxable income under Section 104(a)(2) of the I.R.C.

CONCLUSION

For the reasons stated, the *amicus curiae* EEAC urges the Court to affirm the decision below and hold that monetary settlements under Title VII are on account of "personal injuries" and thus exempt from taxable income under Section 104(a)(2) of the Internal Revenue Code.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-42

UNITED STATES OF AMERICA,

Petitioner,

v.

THERESE A. BURKE, ET AL.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF OF THE NATIONAL WOMEN'S LAW CENTER, AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

Pursuant to Rule 37 of the Rules of this Court, the National Women's Law Center files this brief *amicus curiae* in the above-entitled case. The brief supports the position of the respondents and urges affirmance of the decision of the Court of Appeals below:

The National Women's Law Center has filed with the Clerk of the Court the written consents of the parties to the case.

STATEMENT OF INTEREST

The National Women's Law Center ("NWLC") is a non-profit legal advocacy organization dedicated to

the advancement and protection of women's rights and the corresponding elimination of sex discrimination from all facets of American life. Since 1972, NWLC has worked to secure equal opportunity in the workplace through the full enforcement of Title VII of the Civil Rights Act of 1964, as amended, and other civil rights statutes. Our interest in the instant case is based on our particular and long standing interest in assuring effective remedies for discrimination against women and minorities.

STATEMENT OF FACTS

The facts of the case are fully stated in the opinion of the Court of Appeals below and by the parties. Of particular importance, the Title VII[1] discrimination action brought by the respondents was settled by the payment of $5,000,000, to be distributed according to a formula which took into account length of service and rates of pay of the female employees who were represented in the action. However, there was no attempt to calculate specific awards of "back pay" which would equalize the aggregate wages or salaries received by female employees to those of male counterparts in the same wage or salary classifications.

Female employees had been paid for past services the full amount of wages or salary due by contract with TVA. The settlement proceeds were redress for acts of discrimination in violation of federal statute, and were not based on contract claims.

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[1] Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000e *et seq.*, as amended, hereinafter "Title VII".

SUMMARY OF ARGUMENT

The issue here is whether the settlement proceeds of a Title VII discrimination suit are excludable from federal income taxation under the terms of section 104(a)(2) of the Internal Revenue Code.[2] That section excludes from taxable income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness (except punitive damages in a case not involving physical injury or physical sickness). In determining whether the amount received by suit or agreement is on account of personal injury, the pertinent Treasury regulation states that the term "damages received" means an amount received through prosecution of a legal suit or action based upon tort or tort-type rights or through a settlement agreement entered into in lieu of such prosecution.

The judicial decisions under section 104(a)(2) make it clear that personal injuries include intangible (other than physical or bodily) injuries to the person, including violations of constitutional rights, defamation, and various statutory provisions protecting personal rights. Thus, the Court of Appeals below held that amounts received in a Title VII action by way of settlement of a gender-based discrimination suit are not taxable under section 104(a)(2). This conclusion follows from the view that gender-based discrimination is a personal injury not only resulting in economic inferiority but damaging to intangible personal status, self esteem, morale, and career prospects, *i.e.*, overall personally demeaning. Accordingly, an employer's vi-

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[2] Unless otherwise noted, all references are to the Internal Revenue Code of 1986, as amended. 26 U.S.C. § § 1 *et seq.*

olation of Title VII standards results in a tort-type injury, monetary redress for which is excluded from taxable income.

The petitioner (the "Government") does not appear in its brief to attack the conclusion that tort-like personal injuries include intangible and statutory (Title VII) personal injuries. The Government has argued for a non-statutory, non-regulation distinction between "economic" recoveries and recoveries for injury to "personal capital" and "human capital," meaning harm to bodily parts.

Not only does this distinction have no support in the statute or regulations, but it also makes no real sense and would arbitrarily whittle down the exclusion of section 104(a)(2). It is simply an attempt to revive a long-abandoned Government position limiting section 104(a)(2) to recoveries for injuries to bodily parts. The concept of "personal capital" or "human capital" has no support in the tax law, which does not recognize a tax basis for gain or loss or for depreciation or amortization of this alleged human or personal capital. Moreover, even if the notion had some scintilla of tax validity, the Government argument reflects a very strange view of human beings as a collection of purely physical components, with no sensibilities, no personality, no hopes and fears, no self esteem, and none of those elements that make a human being complete. These intangible elements are plainly also a part of "personal capital," if such a concept is to be tax-cognizable.

Furthermore, the alleged contrast between "economic" recoveries for intangible injuries as "accessions to" or "enhancements" of wealth, and recoveries for injury to personal or human capital as non-accessions to or non-enhancements of wealth is an absurd fiction. To illustrate, by virtue of an accident caused by negligence, a secretary may lose the use of her arms for a while. Nevertheless, redress therefor, measured by lost wages, is an "economic" recovery. If, by virtue of defamation, a person sustains injury to his or her professional reputation, an award for redress of the defamation, measured by loss of income, is also an "economic benefit." If a person recovers money damages for interference with contractual relationships, once more the recovery, which may be basically measured by loss of income, is an "economic benefit." Finally, if a female employee is the victim of invidious and prohibited discrimination, a monetary award as a remedy for this personal injury is an "economic" benefit in the same sense as the foregoing examples. Simply put, where money is recovered for personal injuries, the money is an "economic" benefit.

The Government attempts further to argue that the money received in this case would have been taxable if it had been received as additional wages for past periods. Therefore, it *ought* to be taxable now. This analysis is basically defective. As the facts of this case establish, the settlement amounts received were not equal to and did not have the same effects as "back pay". Moreover, they were paid on account of the personal injury of discrimination. The *measure* of damages for the injuries should not be confused with the nature of the claim. The victims of discrimination did not sue because they were shortchanged by their employer; they sued because discrimination, with all of its concomitants, was illegal and gave rise to personal injuries.

Although the Government brief does not argue about the term "damages," the Court of Appeals for the D.C. Circuit has very recently held in *Sparrow* v. *Commissioner*, No. 90-1151 (Nov. 26, 1991), that an award pursuant to a Title VII action does not constitute "damages" under section 104(a)(2) because Title VII involves only "equitable" remedies under historic distinctions between law and equity. This strained and strange analysis ignores that for numerous purposes of jurisdiction and procedure the distinction between law and equity disappeared decades ago. Moreover, federal *statutory* provisions are not the work of a chancellor in equity. Importantly, the Court of Appeals opinion and decision totally ignores the so-called clean-up doctrine pursuant to which courts of equity have always been able to provide for "damages at law" as a supplement to traditional equitable relief. Finally and decisively, as the Treasury regulations to section 104(a)(2) make clear, all monetary amounts received for personal injuries are excludable as "damages" from income.

Whatever casuistries have been advanced in the attempt to defeat the tax exclusion provided for in section 104(a)(2), the language of that section and the Treasury regulations governs the case before this Court, and it is clear that the section applies to this case. If the executive and judicial branches of Government feel that the section 104(a)(2) exclusion is overbroad and reflects unsound policy, the remedy lies with neither the executive branch nor the courts, and certainly not in statutory construction by legerdemain. Rather, the appropriate remedy is to seek possible limiting provisions in the statute through Congressional action.

ARGUMENT

INTRODUCTION: THE STATUTE AND REGULATIONS

The starting point for analysis of an income tax issue is the statute itself, *i.e.*, the pertinent Internal Revenue Code provision. As a former Solicitor General of the United States and distinguished law professor observed long ago, "There is no use in thinking great thoughts about a tax problem unless the thoughts are firmly based on the controlling statute." Griswold, *Cases and Materials on Federal Taxation*, at 15 (4th ed. 1954). The pertinent statutory provision is contained in section 104 of the Internal Revenue Code, providing as follows:

> (a) In General. -
>
> Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include —
>
> * * *
>
> (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness;
>
> * * *
>
> . . . Paragraph (2) shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness.
>
> * * *

To the extent that Treasury regulations are not inconsistent with the statute itself, they also have binding legal effect. Pertinently here, the regulations provide —

> *Damages received on account of personal injuries or sickness.* - Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

Treas. Regs. § 1.104-1(c).

The statute and the Treasury regulations do not warrant or reflect the "great thoughts" which the Government has offered in its brief. As Justice Blackmun has observed, the purpose of section 104(a)(2) may well be simply "to confer a humanitarian benefit on the victim or victims of tort," referring to a District Court opinion which noted that the statute was "intended to relieve a taxpayer who has the misfortune to become ill or injured." *Norfolk & Western R. Co.* v. *Liepelt*, 444 U.S. 490, 501 (1980) (Blackmun, J., dissenting).

I. "PERSONAL INJURIES" IN THE SENSE OF SECTION 104(a)(2) INCLUDE NON-PHYSICAL INJURIES AS WELL AS PHYSICAL INJURIES

Without exception as far as we know, the courts have recognized that the term "personal injuries" in-

cludes intangible injuries as well as bodily or physical injuries. *See, e.g., Bent* v. *Commissioner*, 87 T.C. 236 (1986), *aff'd*, 835 F.2d 67 (3d Cir. 1987) (violation of First Amendment rights); *Church* v. *Commissioner*, 80 T.C. 1104 (1983) (libel suit); *Seay* v. *Commissioner*, 58 T.C. 32 (1972) (injury to reputation); *Metzger* v. *Commissioner*, 88 T.C. 834 (1987), *aff'd without published opinion*, 845 F.2d 1013 (3d Cir. 1988) (gender and national origin discrimination); *Downey* v. *Commissioner*, 97 T.C. 150 (1991) (violation of ADEA); *Roemer* v. *Commissioner*, 716 F.2d 693 (9th Cir. 1983), *rev'g* 79 T.C. 398 (1982) (defamation); *Rickel* v. *Commissioner*, 900 F.2d 655 (3d Cir. 1990), *aff'g in part and rev'g in part* 92 T.C. 510 (1989) (violation of ADEA). A detailed analysis of the concept of "personal injuries" appears in the recent opinion in *Downey* v. *Commissioner*, 97 T.C. 150, 157-64 (1991), as well as in the opinion below in this case.

II. DISCRIMINATION IN VIOLATION OF TITLE VII RESULTS IN "PERSONAL INJURIES," AND A SETTLEMENT AWARD ON A CLAIM OF SUCH DISCRIMINATION IS RECEIVED ON ACCOUNT OF PERSONAL INJURIES

The opinion of the Court below concluded that discrimination in violation of Title VII undoubtedly resulted in personal injuries. This followed the view of that same Court of Appeals in *Pistillo* v. *Commissioner*, 912 F.2d 145 (6th Cir. 1990), *rev'g* 57 T.C.M. (CCH) 874 (1989), that discrimination in violation of the ADEA gave rise to personal injuries. The Court of Appeals for the Third Circuit has also held that age discrimination resulted in personal injuries. *Rickel* v. *Commissioner*, 900 F.2d 655 (3d Cir. 1990), *aff'g in part and rev'g in part* 92 T.C. 510 (1989).

The Tax Court in the *Rickel* and *Pistillo* cases had denied an exclusion for back pay awards on the ground that the damages received, or part of the damages, were similar to damages for breach of contract and, in any event, were substitutes for taxable income. However, after the Courts of Appeal reversed these analyses and conclusions, the Tax Court in *Downey* v. *Commissioner*, 97 T.C. 150, 168-70 (1991), explicitly overruled its own decisions in the *Rickel* and *Pistillo* cases, on the ground that both the Tax Court previously and the Commissioner had confused the nature of discrimination claims with the consequences of the injury and with the nature of relief requested by taxpayers:

> We recognize that petitioner's recovery here of lost wages is similar to a recovery petitioner might have received in settlement of a contract claim. The record, though, contains no evidence that petitioner had any separate contractual claim .... requesting lost wages as relief; and we have found that petitioner received the amount at issue in settlement of the ADEA claim, not any other claim. Petitioners, thus, were entitled to exclude under section 104(a)(2) the nonliquidated damages received in settlement of the ADEA claim. 97 T.C. at 169-70.

Focusing particularly on Title VII which was the basis for the settlement award here, the purposes of the Title, as stated by Justice O'Connor, are "to deter conduct which has been identified as contrary to public policy and harmful to society as a whole," as well as to make persons whole for the injury suffered on account of discrimination. *Price Waterhouse* v. *Hopkins*, 490 U.S. 228, 264 (1989) (O'Connor, J., concurring).

We do not understand that the Government has contended in its brief that Title VII does not involve tort or tort type rights giving rise to personal injury; rather, in a convoluted way, the Government argues that a "back pay" award, which might have been paid as additional taxable wages if the employer had not engaged in discrimination, ought to be taxable just as such wages would be, notwithstanding section 104(a)(2). This contention is specifically considered below (pages 17-19, *infra*).

III. "DAMAGES RECEIVED" IN THE SENSE OF SECTION 104(a)(2) INCLUDE ANY MONETARY AWARD RECEIVED ON ACCOUNT OF PERSONAL INJURIES

The Treasury regulations define "damages received" as amounts received through a legal suit or settlement agreement based upon tort or tort type rights. Treas. Regs. § 1.104-1(c). Obviously the reference to a legal suit is not an effort to distinguish between actions at law or actions at equity. The plain meaning is an action brought in a court. *See* Federal Rules of Civil Procedure, Rules 1 and 2.

Although the Government brief does not appear to dispute that "damages" were received in the case before the Court, the Court of Appeals for the D.C. Circuit has recently made this an issue. That Court of Appeals held in *Sparrow* v. *Commissioner*, No. 90-1151 (Nov. 26, 1991), that because Title VII is intended to provide equitable relief, and "damages" are historically a remedy at law, an amount received in a Title VII action for discrimination cannot be "damages" within the meaning of section 104(a)(2).

The decision in *Sparrow* is unique, as far as we know, in holding that an amount received for the personal injuries resulting from discrimination does not qualify as "damages." This belated new reading of section 104(a)(2) has no basis.

First, Title VII is not the creation of a chancellor in equity; it is part of a federal statute which reflects a Congressionally-created offense or violation, sets forth procedures, and sets forth remedies. The statute may have equitable overtones in its provisions for injunctive relief, but it is not a branch of equity jurisprudence.

Second, although the Court in the *Sparrow* case correctly noted that "damages" historically were a remedy at law, the Court wrongly concluded that "damages" therefore were not available in equity. Traditionally, courts of equity were not limited to so-called equitable remedies, and frequently applied the equitable clean-up doctrine to award "damages at law" in addition to "equitable" relief. The Court of Appeals in *Medtronic, Inc.* v. *Intermedics, Inc.*, 725 F.2d 440 (7th Cir. 1984), has focused on this historical power of equity courts:

> A suit seeking a mixture of legal and equitable relief could have been brought then, if at all, only in an equity court. A law court could not give equitable relief, incidental or otherwise, while a plaintiff in equity could ask the equity court to grant him *legal* as well as equitable relief—for example, *damages* as well as an injunction—under the equity clean-up doctrine.

725 F.2d at 442 (emphasis added), citing 1 Pomeroy, *A Treatise on Equity Jurisprudence*, § § 236-41

(1881); *Wright* v. *Scotton*, 13 Del. Ch. 402, 417-18, 121 A. 69, 76 (Del. Super. Ct. 1923); Dawson & Palmer, *Cases on Restitution*, 146-51 (2d ed. 1969). *See also Langley* v. *Colonial Leasing Co. of New England*, 707 F.2d 1, 6 (1st Cir. 1983) ("Given the claims for rescission, a chancellor would have had jurisdiction over Langley's whole suit against Major, including the claims for damages at law, under the so-called equitable clean-up doctrine."). Thus, while it is true that courts of law could not order the remedies exclusively available in courts of equity, courts of law had no monopoly on the awarding of damages.

Third, section 104(a)(2), as originally enacted, clearly contemplated that all recoveries for personal injuries, whether through insurance or otherwise, and not just through an award of "damages," were excluded from income. Section 213(b)(6) of the Revenue Act of 1918 first enacted, in a single provision, the income exclusions now contained in sections 104(a)(1) through (3) of the Code. It therefore appears that in this legislation Congress intended generally that recoveries for personal injuries be excludable from income.

Fourth, as limited by the 1989 amendment to section 104(a)(2),[3] the only personal injury recoveries not excludable from income for tax purposes are punitive damages, and then only in a case that does not involve a physical injury. Accordingly, with this sole exception delineated by the *Congress*, all recoveries

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[3] Section 104 was amended by the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7641(a), 103 Stat. 2379 (1989), to provide that section 104(a)(2) "shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness."

for personal injuries, including, *e.g.*, amounts recovered for pain and suffering, are non-taxable.

The distinction between damages at law and equitable damages is thus no distinction at all for purposes of section 104(a)(2). As this Court noted long ago, in rejecting a taxpayer's hypertechnical argument based on historic property law, "the legal paraphernalia which inventive genius may construct as a refuge from surtaxes should not obscure the basic [tax] issue." *Helvering* v. *Clifford*, 309 U.S. 331, 334 (1940). The same observation seems appropriate when courts or administrators seek, by technical niceties or casuistries, simply to increase the federal treasury.

IV. GOVERNMENT THEORIZING ABOUT "PERSONAL CAPITAL" OR "HUMAN CAPITAL," "ECONOMIC BENEFITS," "ACCESSIONS TO WEALTH" OR "ENHANCEMENTS OF WEALTH" IS MISDIRECTED AND PROVIDES NO BASIS FOR LIMITING THE EXCLUSION PROVIDED BY SECTION 104(a)(2)

The government seizes upon the phrases "accession to wealth" and "enhancement of wealth" as they appear in the case of *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955), proposing that these phrases limit the exclusion provided by section 104(a)(2). However, the *Glenshaw Glass* case deals only with the question of what is income under section 22(a) of the Internal Revenue Code of 1939 (section 61 of the present Internal Revenue Code). The issue was whether punitive antitrust damages, *i.e.*, two-thirds of treble antitrust damages, constituted gross income for tax purposes. The Court held sweepingly that any "accessions to wealth" may constitute gross income, observing the "all-inclusive nature of statutory gross income." 348 U.S. at 431, 432 n.11. The *Glenshaw*

Glass case was not a section 104(a)(2) case and did not involve an attempt by this Court to limit the exclusion of that section. To the contrary, since the tax concept of income is generally "all-inclusive," that decision, if anything, emphasized the importance of overriding statutory exclusions. Section 61(a) begins by stating "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived . . . ." The case now before the Court deals with an exception to income, not the general rule. The exception cannot be limited by references to the broad scope of the general rule, as the Government has attempted to argue.

In its brief, the Government seeks to develop a concept for tax purposes of "personal capital" or "human capital," redress for injury to which produces no "economic benefit." On the other hand, monetary damages for intangible injuries, it is asserted, represent "economic benefits," and therefore, in some way not readily apparent, economic benefits do not enjoy the protection from tax provided by section 104(a)(2). This theorizing not only has no support in the tax law generally, but is simply an attempt to engraft a limitation—which appears nowhere else—on section 104(a)(2).

When taxpayers have attempted to invoke the notion of "personal capital" or "human capital" for depreciation or amortization deductions to their tax advantage, the courts have contemptuously dismissed these efforts. As the Court of Appeals for the Seventh Circuit has noted in the case of *Coleman* v. *Commissioner*, 791 F.2d 68, 70 (7th Cir. 1986):

> The billingsgate in appellants' briefs is customary in cases of this nature. Coleman says

> that wages may not be taxed because they come from his person, a depreciating asset. The personal depreciation offsets the wage, leaving no net income. Coleman thinks that only net income may be taxed under the Sixteenth Amendment—net income as Coleman defines it, rather than as Congress does. . . . These are tired arguments.

That Court referred to "hundreds of other cases" holding the same, citing as among them, *United States* v. *Thomas*, 788 F.2d 1250, 1253 (7th Cir.), *cert. denied*, 479 U.S. 853 (1986), *appeal of remand*, 934 F.2d 840 (7th Cir. 1991); *Lovell* v. *United States*, 755 F.2d 517 (7th Cir. 1984); *Granzow* v. *Commissioner*, 739 F.2d 265, 267 (7th Cir. 1984); *United States* v. *Kolibski*, 732 F.2d 1328, 1329 & n.1 (7th Cir. 1984). *See also Lonsdale* v. *Commissioner*, 661 F.2d 71, 72 (5th Cir. 1981).

The Government suggests that damages on account of injuries to human capital would be nontaxable without regard to section 104(a)(2), while damages for other, intangible injuries result in "economic benefits," which are income taxable despite section 104(a)(2). However, in all monetary recovery cases for personal injuries there is in economic terms an accession to wealth, an enhancement of wealth, and an economic benefit. Were the notions proposed by the Government valid, section 104(a)(2) would serve no purpose whatever. Recoveries for bodily injury would, without regard to that section, be nontaxable; other recoveries would be taxable.

The attempt to distinguish "economic" recoveries from "human capital" recoveries is also inherently illogical. All dollar recoveries have an economic effect

and enhance economic wealth, unless property with an equal or greater tax basis is exchanged for the money. A recovery for bodily injury, which temporarily prevents working for wages, results in an "economic benefit" where the award is measured by a loss of wages. In other cases, *e.g.*, libel to professional reputation, damages may well be measured by an estimated loss of income, which, had it been received, would be fully taxable. These damages also produce an economic benefit; nevertheless the damages are excludable from income under section 104(a)(2).

The Government also asserts that Title VII is simply a "back pay" statute as if it were no more than a minimum wage statute. Pursuant to this characterization of Title VII, the Government contends that "back pay," if it had been received as wages in past periods, would have been fully taxable. Therefore, the argument runs, the back pay allegedly received by respondents under this back pay statute simply redresses a shortage of compensation income and should also be taxable. This is a circular argument: compensation for services is taxable; because the damages are allegedly equal to compensation income, the section 104(a)(2) exclusion should not apply; therefore the damages are taxable as compensation income.

The Government has of course omitted to mention this doctrine in the Treasury regulations drafted by the Government. There is a ruling, Revenue Ruling 72-341, 1972-2 C.B. 32, which reaches the Government's conclusion on an admitted back pay award, but the ruling interprets only section 61 of the Internal Revenue Code. It contains no reference to section 104(a)(2) or a limitation thereon. Moreover, contrary to the Government's assumption (Govern-

ment Br. 19), rulings are not the equivalents of Treasury regulations and have no authoritative standing. See *Dixon* v. *United States*, 381 U.S. 68, 73 (1965) (Congress has not given rulings the force of law); *Stubbs, Overbeck & Associates, Inc.* v. *United States*, 445 F.2d 1142, 1146-47 (5th Cir. 1971) (a "ruling is merely the opinion of a lawyer in the agency").

Finally, the Government's argument that the settlement amounts in this case are simply back pay, and taxpayers will be taxed as they should be if the Government prevails, is factually incorrect. The settlement awards were not measured arithmetically as the equivalents of inadequate compensation. The awards, compared to annually received wages, are lump sum, thereby if taxable possibly throwing taxpayers into a higher bracket under section 1 of the Internal Revenue Code. The awards, compared to additional compensation which might have been paid in prior years, are deferred without interest; they do not take into account time values. The victims of Title VII discrimination in this case also for years sustained a lower standard of living, lower prospects of promotion, a loss of self-esteem, stigmatization in effect as "mere female" employees, and other intangible injuries resulting from the discrimination. The settlement awards certainly provide redress for these intangibles as well as past discriminatory lower wages.

In dealing with the argument that the taxpayers in this case should be taxed because additional compensation for past years would have been taxable, the Tax Court has concluded, "Whether the damages paid to the tort victim reflect a substitute for amounts or items otherwise taxable or a substitute for amounts or items to be enjoyed without a tax consequence is

irrelevant." *Downey* v. *Commissioner*, 97 T.C. at 163-64. If any party is to limit a Congressional provision for exclusion, it should not be the tax collecting administration. Nor do courts have the power to rewrite statutes according simply to their views of sound policy. The prerogative of revising the substance of a Congressional Act belongs to the Congress.

Section 104(a)(2) reflects a policy that the Federal Government ought not take its usual tax percentage cut out of situations of misfortune, misery, unfairness and justified unhappiness. The Internal Revenue Service is not entitled to change this statutory policy.

CONCLUSION

For the reasons set forth here, we respectfully request that the opinion and decision of the Court below be affirmed.

Respectfully submitted,

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No. 91-42

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

UNITED STATES OF AMERICA,
Petitioner,

v.

THERESA A. BURKE, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF AMICUS CURIAE OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS IN SUPPORT OF RESPONDENTS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-42

UNITED STATES OF AMERICA,
Petitioner,

v.

THERESA A. BURKE, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF AMICUS CURIAE OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS IN SUPPORT OF RESPONDENTS

INTEREST OF AMICUS CURIAE

The American Association of Retired Persons (AARP) is a nonprofit membership organization of persons age 50 and older that is dedicated to addressing the needs and interests of older Americans. AARP seeks through education, advocacy, and service to enhance the quality of life for all by promoting independence, dignity, and purpose.

More than one-third of AARP's thirty-four million members are employed individuals, most of whom are protected by the Age Discrimination in Employment Act, 29 U.S.C. § 621 *et seq.* (the "ADEA"), and state anti-discrimination laws. One of AARP's primary objectives is to strive to achieve dignity and equality in the work-

place through positive attitudes, practices, and policies regarding work and retirement. Through its research, publications, and training programs, AARP seeks to eliminate ageist stereotypes, to encourage employers to hire and retain older workers, and to help older workers overcome the obstacles they face because of age.

A fundamentnal issue in the case before the Court is the nature of the injury caused by discrimination. The Sixth Circuit Court of Appeals relied on decisions applying Section 104(a)(2) to the ADEA [1] when it ruled that the respondents' Title VII [2] damages resulted from personal injuries, and were therefore excludable from gross income.

Age discrimination, like sex discrimination, injures an individual's rights and personal dignity. Ageism in the workplace causes older persons to feel useless and powerless. It lowers their self-esteem and perceived personal control.

AARP concurs with the arguments set forth by Respondents that Title VII damages should be excludable from gross income as personal injuries under Section 104(a)(2). Given the potential ramifications of this case for victims of age discrimination, AARP submits its brief *amicus curiae* [3] to facilitate a full consideration by the Court of the issues and interests involved in recognizing discrimination as a personal injury.

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[1] *Redfield v. Ins. Co. of North America*, 940 F.2d 542 (9th Cir. 1991); *Pistillo v. Commissioner*, 912 F.2d 145 (6th Cir. 1990); *Rickel v. Commissioner*, 900 F.2d 655 (3d Cir. 1990); *Downey v. Commissioner*, 97 T.C. 150 (1991); *Keller v. Commissioner*, 62 T.C.M. 401 (1991).

[2] 42 U.S.C. § 2000e *et seq.*

[3] The written consents of the parties have been filed with the Clerk of the Court pursuant to Supreme Court Rule 37.3.

SUMMARY OF ARGUMENT

The Government's approach is based on the construction of an artificial category in the tax law to which all victims of discrimination are assigned. This category mistakes the measure of an injury for the injury itself. Moreover, this approach conflicts with the long-standing definition of "personal injury" that is premised on legislative compassion toward tort victims.

A victim of discrimination, whether based on gender or age, suffers an injury implicating the "tort or tort type rights" contemplated by the regulations of the Commissioner of Internal Revenue. 26 C.F.R. § 1.104-1(c). Without explanation, the Government would abandon this straightforward and consistent standard for an approach that is overbroad and unworkable. Moreover, such an approach disregards the sound Congressional purposes underlying the tax treatment of damages for personal injuries.

ARGUMENT

I. THE GOVERNMENT INVOKES AN IMPROPER STANDARD FOR PURPOSES OF IDENTIFYING THE PROTECTED CLASS UNDER SECTION 104 (A)(2).

The statutory exclusion for "any damages received . . . on account of personal injuries," 26 U.S.C. § 104(a)(2), has been interpreted by regulations of the Commissioner of Internal Revenue to include suits based on "tort and tort type rights." 26 C.F.R. § 1.104-1(c). From these simple elements the courts have synthesized an easily administrable standard:

> [Personal injury means any invasion of] the rights that an individual is granted by virtue of being a person in the sight of the law.

Rickel v. Commissioner, 900 F.2d at 663, *quoting Threlkeld v. Commissioner*, 87 T.C. 1294, 1308, *aff'd*, 848 F.2d

81 (6th Cir. 1988). Over the last 73 years, the exclusion rule of Section 104(a)(2) has been applied to a large number of cases with remarkably little statutory adjustment.[4]

The courts have applied the definition of personal injury consistently and responsibly, holding that the element of personal injury inheres in a variety of non-physical injuries, notwithstanding the fact that lost earnings are used to measure damages for purposes of fixing compensation. *Redfield*, 940 F.2d 542; *Burke v. United States*, 929 F.2d 1119 (6th Cir. 1991); *Pistillo*, 912 F.2d 145; *Rickel*, 900 F.2d 655; *Threlkeld*, 848 F.2d 81; *Byrne v. Commissioner*, 883 F.2d 211 (3d Cir. 1989); *Metzger v. Commissioner*, 88 T.C. 834 (1987), *aff'd without published opinion*, 845 F.2d 1013 (3d Cir. 1988); *Downey*, 97 T.C. 150; *Keller*, 62 T.C.M. 401; *Madson v. Commissioner*, 55 T.C.M. 1351 (1988). This definition has not impaired the ability of the courts to make appropriate distinctions between actions for personal injuries and actions for breach of employment contracts. *See, e.g., Nagourney v. Commissioner*, 57 T.C.M. 954 (1989), *aff'd without published opinion*, 904 F.2d 700 (4th Cir. 1990); *Kurowski v. Commissioner*, 917 F.2d 1033 (7th Cir. 1990).

The Government offers no reason to depart from this long-standing definition. Virtually abandoning the Commissioner's own formula ("tort or tort type rights"), the Government advances no explanation of what it understands "personal injury" to mean under Section 104(a)(2). The Government would treat Title VII claimants, ADEA plaintiffs, and other victims of discrimination identically for purposes of Section 104(a)(2) on the theory that the measure of damages in their cases is based in whole or in part on lost earnings. While purporting to respect the settled decisions on physical injuries and classical common law torts, the Government's argument cannot be so limited, for it would exclude from Section 104(a)(2) even traditional tort victims who receive damages for impaired earning ability.

[4] The first real change in the language of the exclusion rule at issue in this case did not occur until 1989, and does not affect these proceedings. *See* 26 U.S.C. § 104(a)(2) (final sentence); H.R. Conf. Rep. No. 386, 101st Cong., 1st Sess. 622-23, *reprinted in* 1989 U.S. Code Cong. & Admin. News 3225-26.

The Government's acknowledgement of the applicability of Section 104(a)(2) to an outright loss of employment, *cf.* Rev. Rul. 85-97, cannot be reconciled with the Government's opposition to exclusion in the case of a partial loss. Section 104(a)(2) contains no factor suggesting a distinction among tort victims on the basis of total or partial loss of employment opportunities.[5]

II. SECTION 104(A)(2) EXTENDS LEGISLATIVE COMPASSION TO "TORT AND TORT TYPE" VICTIMS.

The Government's approach to the exclusion rule of Section 104(a)(2) confines itself to the economic policy of avoiding the imposition of an income tax on capital. Pet. Br. 13-14. The Government advances this theoretical consideration as the only support in *Roemer v. Commissioner*, 716 F.2d 693 (9th Cir. 1983), for applying Section 104(a)(2) to non-physical injuries. However, the Government's approach ignores the *Roemer* court's explanation of Section 104(a)(2):

> The rationale behind the exclusion of the entire award [including damages for lost earnings] is apparently a feeling that the injured party, who has suffered enough, should not be further burdened with the practical difficulty of sorting out the taxable and nontaxable components of a lump-sum award.

716 F.2d at 696.

[5] If such a distinction were found to exist, it would seem inconsistent with Section 104(a)(1), which offers a parallel exclusion in the case of damages in the nature of workmen's compensation. *See* 26 U.S.C. § 104(a)(1).

The Congressional goal in enacting the predecessor of Section 104(a)(2) in 1918 could not have been merely to prevent the imposition of an income tax on "capital," since the prevailing view at that time perceived constitutional impediments to such taxation. *See Eisner v. Macomber*, 252 U.S. 189 (1920). Neither Section 104(a)(2) nor its regulations were modified in the wake of *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, *rehearing denied*, 349 U.S. 925 (1955), to reflect the capital-shielding role the Government would now thrust upon Section 104(a)(2). On the contrary, one year after the decision in *Commissioner v. Glenshaw Glass Co.*, the Commissioner of Internal Revenue promulgated regulations making clear that this broad statutory exemption included proceeds from "the prosecution of a legal suit or action based upon tort or tort type rights." 26 C.F.R. § 1.104-1(c). The *Roemer* court understood the significance of *Commissioner v. Glenshaw Glass Co.* as diluting the tax-theoretical "capital" objection to taxation of personal injuries:

> Since there is no tax basis in a person's health and other personal interests, money received as compensation for an injury to those interests might be considered a realized accession to wealth. Nevertheless, Congress in its compassion has retained the exclusion (now codified at I.R.C. § 104(a)(2)).

Roemer, 716 F.2d at 696. (emphasis added.)

The definition of personal injury adopted by the courts for purposes of Section 104(a)(2)—any invasion of the "rights that an individual is granted by virtue of being a person in the sight of the law," *Rickel*, 900 F.2d at 663, —furthers the legislative compassion recognized by the Ninth Circuit in *Roemer*. Moreover, there is no link between this definition of personal injury and the purely tax-theoretical shielding of capital as suggested by the Government.

III. AGE DISCRIMINATION, LIKE SEX DISCRIMINATION, IS A PERSONAL INJURY.

Age discrimination can have devastating psychological and sociological effects on an individual as it causes feelings of uselessness and powerlessness.[6] Lowered self-esteem and personal control also result from the perception of age discrimination,[7] which can lead to burnout and personal strain.[8]

The typical victim of age discrimination has dedicated his life to a company and his self-worth is tied to his status as an employee for that company. For such employees, "the shock of compulsory retirement may be so overwhelming as to generate a lasting state of anxiety and even depression."[9] Thus, forced retirement, not age, can be the cause of a significant decline in mental and physical ability, as such discrimination condemns individuals to "an idleness that hastens their decline."[10]

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[6] *See* Cowgill, *The Aging Population and Societies*, 415 Annals of the American Academy of Political and Social Science 1-18 (1974); Butler, *Ageism: Another Form of Bigotry*, 9 The Gerontologist 243-246 (1969).

[7] Hassell and Perrewe, *An Examination of the Relationship Between Older Workers' Perceptions of Age Discrimination and Employee Psychological States* (unpublished 1991).

[8] Perrewe, Brymer, Stepina, and Hassell, *A Causal Model Examining the Effects of Age Discrimination on Employee Psychological Reactions and Subsequent Turnover Intentions*, Int'l. J. of Hospitality Mngt. (1991).

[9] McDougal, Lasswell & Chen, *The Human Rights of the Aged: An Application of the General Norm of Nondiscrimination*, 29 U. Fla. L. Rev. 639, 641 (1976).

[10] McDougal, Lasswell & Chen, *The Human Rights of the Aged: An Application of the General Norm of Nondiscrimination*, 29 U. Fla. L. Rev. 639, 642 (1976); Somers, *Social, Economic, and Health Aspects of Mandatory Retirement*, 6 J. of Health, Politics, Policy & Law 542, 547 (1981) (studies show that the mortality rates of older persons increased after involuntary retirement).

Recognition of the personal trauma of age discrimination has remained in the forefront of federal legislative policies with respect to age discrimination. The Select Committee on Aging has reaffirmed Congressional views on the devastating personal effects of age discrimination:

> Compulsory retirement robs those affected of the will to live full, well-rounded lives, deprives them of opportunities for compelling physical and mental activity and encourages atrophy and decay . . . .
>
> There is ample clinical evidence that physical and emotional problems can be precipitated or exacerbated by denial of employment opportunities. Few physicians deny that a direct relationship exists between enforced idleness and poor health.

Mandatory Retirement: The Social and Human Cost of Enforced Idleness, 95th Cong., 1st Sess., Comm. Pub. 91, at 22 (1977).

The courts have readily discerned the same objectives:

> [A]ge discrimination in employment is a tragic waste of human resources . . . the result of [u]nfavorable beliefs and generalizations about older persons [which] have grown up over the years and, in many instances, have hardened into restrictive policies and practices.

Christie v. Marston, 551 F.2d 1080, 1084 (7th Cir. 1977) (citations omitted).

> The [ADEA] was intended to alleviate the serious economic and psychological suffering of people between the ages of 40 and 65 caused by widespread job discrimination against them.

Brennan v. Paragon Employment Agency, Inc., 356 F. Supp. 286, 288 (S.D.N.Y. 1974), *aff'd without opinion*, 489 F.2d 752 (2d Cir. 1974).

> The purpose of the ADEA was to alleviate serious economic and psychological suffering of persons within this age range [40-65], caused by unreasonable prejudice and job discrimination.

Polstorff v. Fletcher, 452 F. Supp. 17, 23 (N.D. Ala. 1978).

The injury suffered by victims of discrimination whether based on age, gender, or race, is much more than the economic loss of a contract. It is not simply the lost income from a job but the damage to a worker's social role and psychological security. Although sometimes measured with reference to lost earnings, age discrimination is an invasion of one of the most basic rights that individuals are granted by virtue of being persons in the sight of the law: the feeling that they have not outlived their usefulness. *Cf. Rickel*, 900 F.2d at 663; *Threlkeld*, 87 T.C. at 1308.

IV. THE GOVERNMENT'S OVERBROAD TREATMENT OF TITLE VII AND THE ADEA IGNORES CRUCIAL STATUTORY VARIATIONS.

The Government suggests a sweeping approach that treats all damages for employment discrimination the same. Such an overbroad approach ignores crucial differences in the remedies available under state and federal laws other than Title VII or the ADEA and the accepted tax treatment of such damages.[11] It also fails to account for the uniform exclusion under Section 104(a)(2) of liquidated damages under the ADEA, damages which are unavailable under Title VII.

Almost every state has adopted statutes prohibiting sex and age discrimination.[12] Neither Title VII nor the

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[11] A similar artificial distinction would be introduced by the dichotomy between actions at law and actions in equity, recently employed by the Court of Appeals for the District of Columbia Circuit in *Sparrow v. Commissioner*, 91-2 U.S.T.C. ¶ 50,567 (D.C. Cir. 191) to exclude from Section 104(a)(2) back pay damages received in settlement of a civil rights action under Title VII.

[12] Forty-six states plus the District of Columbia currently have laws prohibiting age discrimination against private and public employees. *See* Alaska Stat. § 18.80.220(a)(1); Cal. Gov't Code

ADEA preempts state law tort damages, including emotional distress, or pendent state claims. *See, e.g., Cancellier v. Federated Dept. Stores*, 672 F.2d 1312, 1318 (9th Cir.), *cert. denied*, 459 U.S. 859 (1982). The injuries suffered by victims under these state statutes clearly transcend the loss of a contract right. *See, e.g., Moody v. Pepsi-Cola Metropolitan Bottling Co., Inc.*, 915 F.2d 201, 210 (6th Cir. 1990):

> [The victim] specifically testified that he was shocked and humiliated .... [He] later moved away from his family in order to maintain employment, and he testified that he believed the move had an adverse effect on his marriage. [His] wife testified that he was upset to the point of crying and that he never really overcame the shock and humiliation of the termination.

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§ 12941(a); Colo. Rev. Stat. § 8-2-116; Conn. Gen. Stat. § 46a-60(a)(1); Del. Code Ann. tit. 19, § 710(7); D.C. Code Ann. § 1-2502(2); Fla. Stat. § 760-01-10, 112.043-44; Ga. Code Ann. §§ 34-1-2(a), 45-19-20 to 42; Haw. Rev. Stat. § 378-2; Idaho Code § 67-5910(7); Ill. Rev. Stat. ch. 68, para. 1-103(a); Ind. Code § 22-9-2-1; Iowa Code § 601A.6(1)(2); Kan. Stat. Ann. § 44-1115; Ky. Rev. Stat. Ann. § 344.010(4); La. Rev. Stat. Ann. § 972; Me. Rev. Stat. Ann. tit. 5, § 4572; Md. Code Ann. art. 49B, § 16(a); Mass. Gen. Laws Ann. ch. 151B, § 1(8); Mich. Stat. Ann. § 3.548 (202); Minn. Stat. §§ 181.81, 363.03(1), (2); Mo. Rev. Stat. § 213.055(1); Mont. Code Ann. § 49-2-303(1); Neb. Rev. Stat. § 48-1003(1); Nev. Rev. Stat. § 613.330(a); N.H. Rev. Stat. Ann. § 354-A:8(I); N.J. Rev. Stat. § 10:5-2.1; N.M. Stat. Ann. § 28-1-7 (A); N.Y. Exec. Law § 296(3-a)(a); N.C. Gen. Stat. §§ 126-16, 143-416.2; N.D. Cent. Code § 14-02.4-02(1); Ohio Rev. Code Ann. § 4112.02; Okla. Stat. Ann. tit. 25, § 1302.(1); Or. Rev. Stat. § 659.030(1)(a),(b); 43 Pa. Cons. Stat. § 954(h); R.I. Gen. Laws § 28-5-6(J); S.C. Code Ann. § 1-13-30(c); Tenn. Code Ann. § 4-21-101; Tex. Rev. Civ. Stat. Ann. art. 5221k, § 1.04(a); Utah Code Ann. § 34-35-6(1)(a); Vt. Stat. Ann. tit. 21, § 495(c); Va. Code Ann. § 2.1-116.10; Wash. Rev. Code § 49.44.090(1); W. Va. Code § 5-11-3(q); Wis. Stat. Ann. § 111.33(1); Wyo. Stat. § 27-9-105(b). Three states only cover public employees in their state laws. *See* Ark. Stat. Ann. § 12-3502; Miss. Code Ann. § 25-9-149; S.D. Codified Laws Ann. § 3-6A-36.1. Alabama has no age discrimination in employment law.

Remedies for age and sex discrimination also include actions asserting violations of constitutional guarantees of equal protection. Damages for such constitutional violations have been excluded from income pursuant to Section 104(a)(2). *See, e.g., Madson v. Commissioner*, 55 T.C.M. 1351, 1352-54 (1988) (section 104(a)(2) excludes from income all proceeds received in settlement of action alleging violation of equal protection under the Constitution, notwithstanding the fact that damages consisted principally of lost earnings).

The Government's approach simply fails to accommodate the diverse remedies provided by state laws and the Constitution under which damages would clearly be excluded. Victims of age discrimination cannot always choose the forum or law under which their rights are asserted because agencies like the Equal Employment Opportunity Commission may initiate the age discrimination action on behalf of a group. Once commenced, a federal age discrimination lawsuit may, for practical purposes, foreclose remedies based on state law rights, thereby depriving individuals of more tax-advantageous fora under the Government's interpretation. Victims of discrimination would be forced to elect among federal suits, state statutory actions, state tort law, and other remedies in part on the basis of federal income tax considerations.

The Government's approach is also overbroad because it ignores a significant statutory difference between Title VII and the ADEA—the role of liquidated damages under the ADEA. While the nature of the injury and the remedies provided for age and sex discrimination are generally the same, the ADEA's provision of liquidated damages cannot be swept along with the Government's overbroad approach.

Unlike Title VII, the ADEA permits recovery of liquidated damages in the case of willful behavior on the part of the defendant. 29 U.S.C. § 626(b). Liquidated

damages are defined by statute to be equal to the amount of any lost earnings of the victim of age discrimination. 29 U.S.C. § 216(b). The ADEA also permits recovery of additional damages for loss of fringe benefits, insurance benefits, pension benefits, and retirement benefits. 29 U.S.C. § 626(b). The courts now uniformly hold that both lost earnings and liquidated damages under the ADEA are excludable from gross income under Section 104(a)(2). *Redfield*, 940 F.2d 542; *Pistillo*, 912 F.2d 145; *Rickel*, 900 F.2d 655; *Downey*, 97 T.C. 150; *Keller*, 62 T.C.M. 401. No court has ever held ADEA liquidated damages not to be excludable under Section 104(a)(2).

The Government's rationale for taxing the earnings lost from discrimination cannot apply to recipients of ADEA liquidated damages because they have already received compensation for lost earnings damages. Furthermore, since only victims of willful behavior are entitled to ADEA liquidated damages, there is no basis for characterizing such proceeds as deferred wages. The fact that the Sixth Circuit Court of Appeals partially relied on ADEA precedent does not justify the Government's wholesale grouping of the tax treatment of ADEA liquidated damages with ordinary damages.

CONCLUSION

Discrimination falls within the long-standing definition of personal injury because it invades a person's rights. The Congressional desire for expansive tax treatment of personal injury damages would be frustrated by adopting distinctions absent from the statute and regulations. The decision below furthers the Congressional intent underlying Section 104(a)(2) and should be affirmed.

Respectfully submitted,

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No. 91-42

In The Supreme Court of the United States October Term, 1991

UNITED STATES OF AMERICA,
Petitioner,

v.

THERESE A. BURKE, *et al.*,
Respondents.

BRIEF OF WOMEN EMPLOYED, 9TO5, NATIONAL ASSOCIATION OF WORKING WOMEN AND CHICAGO LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW, INC. AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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No. 91-42

In The Supreme Court of the United States October Term, 1991

UNITED STATES OF AMERICA,
Petitioner,

v.

THERESE A. BURKE, *et al.*,
Respondents.

BRIEF OF WOMEN EMPLOYED, 9TO5, NATIONAL ASSOCIATION OF WORKING WOMEN AND CHICAGO LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW, INC. AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

INTEREST OF AMICI CURIAE

Women Employed is a membership association of 2,000 women at all employment levels. It conducts innovative research, education and advocacy programs designed to improve women's economic status. Since its founding in 1973, the organization has achieved national recognition for its efforts to increase employment opportunities for women by advocating improved equal opportunity policies and greater access to vocational education and job training systems, and by developing model programs to enable disadvantaged women to become economically self-sufficient.

9to5, National Association of Working Women, is a voluntary association with more than 15,000 members nationwide. It is the preeminent membership organization for the nation's 20 million office workers. Headquartered in Cleveland, Ohio, with offices on the east and west coasts, chapters in twenty-six states, and members in all states, it works toward the eradication of

discrimination based on sex, race, age, color, religion, disability, national origin, ancestry, or sexual preference.

The Chicago Lawyers' Committee for Civil Rights Under Law, Inc. ("Lawyers' Committee") was founded in 1969 by major Chicago law firms to involve private attorneys in the effort to assure the civil rights of all persons in the metropolitan area. Since its inception, the Lawyers' Committee has enlisted the *pro bono* legal services of many hundreds of attorneys in addressing the legal problems of members of minority groups, women, the disadvantaged, and the poor in employment, housing, education, the administration of justice, voting, and law enforcement.

Of particular concern to the amici and their members is the full recovery of compensation permitted by law for the victims of discrimination. Amici have devoted substantial energy and resources to the protection of remedies available to persons who have suffered discrimination. Those efforts have included litigation, legislative advocacy, and the filing of briefs as amicus curiae.

Amici believe the decision of the court of appeals is correct, and submit this brief to assist the Court in resolution of the case. [1]

INTRODUCTION AND SUMMARY OF ARGUMENT

Section 104(a)(2) of the Internal Revenue Code (the "Code"), 26 U.S.C. §104(a)(2), excludes from the definition of gross income "the amount of any damages received on account of personal injuries." Title VII of the Civil Rights Act of 1964, 42 U.S.C. §2000e, *et seq.* ("Title VII"), makes it unlawful to discriminate, in respect to employment, on the basis of race, sex or national origin. Application of §104(a)(2) to Title VII recoveries is, on its face, quite straightforward: The discrimination outlawed by Title VII invades a plaintiff's right to be free of such invidious discrimination and is a "personal" injury. Title VII is an antidiscrimination law, not a backpay provision; backpay is simply an enforcement tool under that statutory scheme. Thus,

[1] The parties' letters of consent, pursuant to Rule 37 of the Rules of this Court, have been filed with the Clerk.

any damages received on account of an injury under Title VII should be excluded by §104(a)(2).

To avoid this result, however, the Internal Revenue Service ("the Service") urges this Court to use the case before it to create, within the §104(a)(2) tax exclusion, a tortured and untenable distinction between "physical" and "nonphysical" injuries. As to physical injuries, the Service is willing to give §104(a)(2) its clear and obvious meaning of excluding "any damages"; however, as to "nonphysical" injuries, the Service would graft onto §104(a)(2) an additional "burden" on the taxpayer "of establishing that the recovery is reimbursement for a prior loss of personal capital and does not represent a gain or profit that instead adds to her wealth." (Citations omitted). Petitioner's Brief at 14-15.

The Service's attempt to rewrite the Code must be rejected. There is no support in §104(a)(2) for a two-tiered physical/nonphysical injury distinction, in which the victim of a nonphysical injury must shoulder such an additional burden to gain the benefit of the §104(a)(2) exemption. Moreover, there is no basis in §104(a)(2) for a limitation of this exclusion to what the Service terms a "return" of personal "capital." The Service's approach to §104(a)(2) should be rejected by this Court, as it has been by the vast majority of courts of appeals and by the Tax Court.

The Service's distinction also creates an unfair relative tax disadvantage for victims of nonphysical, as opposed to physical, injuries. Such different treatment for victims of nonphysical personal injuries, including discrimination under Title VII, furthers no Congressional purpose, has no basis in tax or civil rights policy and complicates and discourages settlement of discrimination cases – a result directly contrary to Congress' intent in enacting Title VII.

Finally, amici urge this Court to decline the Service's invitation to use this case, in which the Service argues plaintiffs are receiving additional payment for "work already performed," Petitioner's Brief at 18-20, to create a wholesale emasculation of the §104(a)(2) tax exclusion. Amici agree with the court of appeals in this case that plaintiffs were entitled to the benefit of the §104(a)(2) exclusion. However, if this Court should reverse the decision below, amici ask this Court to recognize that many

Title VII victims do not, in any sense, receive pay for work already performed. Amici respectfully submit that any holding in favor of Petitioner in this case should be carefully limited to differential pay situations.

ARGUMENT

I. Title VII Victims Have Suffered Personal Injuries.

If this Court simply applies the language of the §104(a)(2) exclusion to the case before it, rather than accepting the Service's approach, application of §104(a)(2) to Title VII generally, as well as this case, is quite straightforward.

Section 104(a)(2) of the Internal Revenue Code excludes from gross income, with certain specific limitations that are not relevant here,[2] the following:

> the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.

26 U.S.C. §104(a)(2).

Title VII makes unlawful various forms of discrimination, including:

> to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin.

42 U.S.C. §2000e-2.

The applicable Treasury Regulation provides that, under §104(a)(2):

> The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

26 C.F.R. §1.104-1(c).

[2] These limitations are for amounts attributable to medical expense deductions and for punitive damages. 26 U.S.C. §104(a).

Thus, the question before the Court is simply whether discrimination, such as that outlawed by Title VII, is a "personal injury" that is in the nature of a personal tort. A tort is "a legal wrong committed upon the person or property independent of contract" such as "a direct invasion of some legal right of the individual." BLACK'S LAW DICTIONARY 1335 (5th ed. 1979).

A violation of Title VII is clearly a torttype wrong and illegal discrimination is very much a "personal" injury. The duty not to discriminate arises independently of any contractual relationship the parties may have. Indeed, Title VII expressly extends to situations in which the parties have no contractual relationship, such as where an employer refuses to hire on the basis of race, sex, religion or national origin. 42 U.S.C. §2000e-2.

This Court has recognized, even in reference to 42 U.S.C. §1981, which refers specifically to the right to "make and enforce contracts," that such federal laws, outlawing racial discrimination, create a personal injury claim. This Court has described discrimination as a "fundamental injury to the individual rights of a person." *Goodman v. Lukens Steel Co.*, 482 U.S. 656, 662 (1987). In that case, the Court incorporated the statute of limitations for personal injury claims as the most appropriate statute for §1981 actions. As this Court noted in *Goodman*:

> That §1981 has far-reaching economic consequences does not change the conclusion, since such impact flows from guaranteeing the personal right to engage in economically significant activity free from racially discriminatory interference.

482 U.S. at 661-662.

Title VII is, like §1981, an antidiscrimination statute. Title VII is not, in any sense, a backpay statute. Backpay is one of many potential remedies provided by Congress to promote Title VII enforcement. *See* 42 U.S.C. §2000e-5(g). Title VII does not,

however, regulate the pay an employer provides. *Cf.* 29 U.S.C. §§206 and 207 (fair Labor Standards Act requiring minimum wage and overtime payments). What Title VII prohibits is discrimination, which strikes at the very personhood of its targets, and constitutes a very real and very "personal" injury for its victims.

In short, the amount Title VII plaintiffs receive because they suffer discrimination is undeniably money received "on account of personal injuries." Therefore, §104(a)(2) operates to exclude this recovery from the victim's income.

II. There is No Basis for the Service's Distinction Between "Physical" and "Nonphysical" Injuries Under §104(a)(2) Or Its Requirement that Victims of Nonphysical Injuries Show that Their Recoveries Constitute a "Return of Capital."

In order to avoid a straightforward application of §104(a)(2) to Title VII, the Service asks this Court to adopt and apply the following test to victims of "nonphysical" personal injuries:

> For Section 104(a)(2) to be applicable to a recovery involving a nonphysical injury to personal rights, the taxpayer . . . has the burden of establishing that the recovery is reimbursement for a prior loss of personal capital and does not represent gain or profit that instead adds to her wealth.

Petitioner's Brief at 14-15 (citations omitted).

The Service recognizes, however, as this Court has also acknowledged, that, as to victims of *physical* injuries, lost income recoveries are excluded from income by §104(a)(2). Petitioner's Brief at 21-22, n.16. *See Norfolk & W. Ry. v. Liepelt,* 444 U.S. 490, 496-98 (1980). (Lost future income recovered in a wrongful death case excluded by §104(a)(2).) There is no legal or logical basis for treating victims of *nonphysical* injuries any differently or for imposing upon them the additional burden of showing that their recovery is a "return of capital."

Nothing in the language of §104(a)(2) supports a two-tiered approach for victims of physical and nonphysical personal

injuries. Indeed, the absence of any such distinction in §104(a)(2) is underscored by the fact that, in 1989, Congress amended §104(a) to provide that Section (a)(2) "not apply to any punitive damages in connection with a case not involving physical injury or physical sickness." Pub.L. 101-239, §7641(a), 103 Stat. 2379 (1989)(codified, as amended, at 26 U.S.C. §104(a)). The 1989 amendment, in adding a *specific* distinction relating to punitive damages received for nonphysical personal injuries, makes clear that there is not, and never has been, any *general* distinction between "physical" and "nonphysical" personal injuries under §104(a)(2).

Petitioner argues that exclusions from income "are to be construed narrowly." Petitioner's Brief at 21. Strict construction cannot, however, provide a basis for rewriting tax exemptions. Exemptions to the Internal Revenue Code are "specifically stated and should be construed with restraint in light of the same policy." *Commissioner v. Jacobsen*, 336 U.S. 28, 49 (1949). As with any statute, interpretation "must begin with the statute's language." *Mallard v. U.S. District Court*, 490 U.S. 296, 300 (1989). The plain meaning of such language is generally conclusive. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989). *See also West Virginia University Hospitals, Inc. v. Casey*, ___ U.S. ___, 111 S.Ct. 1138, 1148 (1991). In *Norfolk & W. Ry. v. Liepelt*, 444 U.S. at 498, this Court viewed the language of §104(a)(2) to be "perfectly clear" in excluding from taxation damages for lost future income recovered in a wrongful death case. Nothing in the statutory language suggests a different rule for lost income caused by race or sex discrimination or other "nonphysical" injuries.

Absent support in the statutory language, the Service attempts to extract support for its "return of capital" theory from the underlying legislative intent. There is no support for this theory in the legislative history. Even if there were, the Service offers no support for its argument that a damage recovery for nonphysical injury must satisfy a return of capital standard in order to be described in §104(a)(2), while a damage recovery for physical injury need not.

To begin with, the Service says (Petitioner's Brief at 10) that the original purpose of the statutory exclusion for personal injury

damages was to "implement" the 1918 decision in *Doyle v. Mitchell Brothers Co.*, 247 U.S. 179 (1918). Yet the committee reports contain no reference to this case, nor do they contain a shred of other evidence to back up the assertion made in the Service's brief. H.R. REP No. 767, 65th Cong., 2d Sess. 9-10 (1918); S. REP. No. 617, 65th Cong., 3rd Sess. 29-30 (1918). The issue in the *Mitchell Brothers* case was whether a lumber company's tax basis in its uncut timber was the timber's original cost, or its value as of the effective date of the tax act in question (the Corporation Tax Act of 1909). There is no reason in the legislative history, or in logic, for this Court to infer any connection whatsoever between *Mitchell Brothers* and the statutory exclusion of personal injury damages.

The 1918 committee reports do not say that, under the preexisting statute, personal injury damages were clearly taxed, or clearly not taxed (in which case there would have been no reason for the enactment). The reports say, without explanation, that taxation under the existing statute was "doubtful," and that under the new statute such damages "shall not be included in income." H.R. REP. No. 767 at 9-10, S. REP. No. 617 at 29-30. There is no reference to the return of capital theory or any other tax policy.

The absence of any reference to the return of capital theory is not surprising. This theory offers no persuasive reason why replacement of past or future earnings should be excluded from income, whether the injury be physical or nonphysical. If the capacity to labor is a capital asset that is merely exchanged or converted to money, producing no net gain, then wages actually earned would not be "income" either.

The return of capital theory also does not explain how the amount of "capital" invested in the human person should be measured in order to determine the tax consequences of such items as damages for pain or impairment. If an accident victim loses the use of an eye, why should one assume in every case that there is invested capital (or tax "basis") in the use of the eye, and that the amount of basis is at least as much as the damages recovered? Apparently, the "return of capital" theory also assumes infinite basis, so that there can never be any taxable gain when the eye, or some other human capacity, is converted

to money damages. Surely if a taxpayer *sold* his eye for medical or other use, the Service would not acknowledge any capital or basis in the eye, and would tax the full proceeds as income.

As many commentators have noted, the "return of capital" theory simply does not provide the basis for the exclusion of §104(a)(2), and there is no persuasive evidence that Congress would have thought so, or did in fact think so. The full Tax Court, sitting *en banc* earlier this year, put it well:

> We doubt whether the return of capital theory justifies the exclusion from income of the full range of damages found to be excludable under section 104(a)(2), particularly damages received in lieu of lost income. Perhaps, even originally, a more satisfactory justification for excluding a recovery for lost earnings as well as a recovery for pain and suffering may have been based on emotional and traditional, rather than logical, factors. Whatever reasons initially motivated Congress to enact an exclusion for damages received on account of personal injuries or sickness, a contemporary inquiry must by necessity restrict itself to the language of section 104(a)(2), and administrative and judicial interpretations of that language.

Downey v. Commissioner, 97 T.C. 150, 159 (1991)(citation to scholarly articles omitted).

The Service asks the Court to infer not only that Congress intended to adopt the return of capital theory but also that its intent was even more specific — *i.e.*, that §104(a)(2) silently intends to impose the return of capital theory, whatever that means, on recoveries for nonphysical personal injuries but not physical personal injuries. There is no evidence of any such intent, and the Court should not infer it.

Absent support in the statutory language or legislative intent, the Service resorts to its own history of interpreting §104(a)(2) and its predecessors. The Service advises the Court that, in 1920, the Service conjectured that the 1918 statute was "[p]robably . . . merely declarative" of the human capital theory. Solicitor's Memorandum 1384, 2 C.B. 71, 72; *revoked* by Solicitor's Opinion 132, I-1 C.B. 92, 94 (1922).

After 1922, the Service says that its position was based on two beliefs that have since been shown to be wrong. First, the Service says it believed the statutory exclusion for personal injury damages embodied a general distinction between physical and nonphysical injuries. Petitioner's Brief at 11-12. As discussed *supra* at 7, the 1989 amendment of §104(a)(2) would make no sense if this general distinction existed. Moreover, even the Service now grudgingly acknowledges that recoveries for both physical and nonphysical personal injuries must be analyzed under the specific §104(a)(2) exclusion. Petitioner's Brief at 14, n.13.

Second, the Service says it believed a separate statutory exclusion for nonphysical injuries was in large part unnecessary, because the return of capital theory would make a tax on such damages unconstitutional in any event. Petitioner's Brief at 12-13. However, the notion of a constitutional restriction that would limit the kinds of income Congress can tax has also proven wrong. *See Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955), discussed *infra*.

The Service in effect cites its own long record of erroneous interpretation on this issue as a reason why this Court should now rescue the Service from the clear language of §104(a)(2) and the weight of lower court authority. The Service's own long record of error is no reason for the Court to adopt the Service's strained and unsupported interpretation of §104(a)(2).

Nor can the Service derive any support for its two-tiered additional burden approach from the case law. *Commissioner v. Glenshaw Glass Co., supra*, apparently forms the basis for much of the Service's argument. *See* Petitioner's Brief at 7, 9, 13, 15, 18 & 21. That case, however, offers absolutely no support for the Service's position. *Glenshaw Glass* held that the punitive portion of treble damages received by a corporation was "income" under the predecessor of §61 of the Internal Revenue Code. Some taxpayers, based on *dictum* in *Eisner v. Macomber*, 252 U.S. 189, 207 (1920), had argued that the general concept of "income" under the Code was limited to returns derived from the taxpayer's labor or capital. This notion was rejected. The only statutory *exclusion* from gross income that was considered in *Glenshaw Glass* was the exclusion for gifts. 348 U.S. at 432. The Court

had no reason even to consider "any other exemption under the Code." *Id.* The case involved no personal injury, and the Court neither rejected nor adopted any position of the Service regarding compensation for personal injuries. 348 U.S. at 432, n.8.

The Service's further reliance (Petitioner's Brief at 14) on *Starrels v. Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962), in support of its two-tiered additional burden approach to nonphysical injuries under §104(a)(2), ignores the very real injury caused to victims of nonphysical injuries, such as discrimination. *Starrels* held that a payment to a taxpayer in return for an *agreement* to allow a motion picture to be made regarding her family was not excluded by §104(a)(2). The court rejected the taxpayer's argument that §104(a)(2) excluded from taxation payments made in return for the taxpayer selling her privacy rights. That case makes perfect sense but it has no application here. Title VII plaintiffs do not, in any sense, voluntarily agree to be victims of discrimination, nor do they sell their rights to be free of discrimination, in return for an award of backpay. They have been victims of an "actual invasion of personal rights," 304 F.2d at 576, and thus, as the *Starrels* court itself would have recognized, are entitled to the §104(a)(2) exclusion.

Social Security Board v. Nierotko, 327 U.S. 358 (1946), relied on by Petitioner at 19, 26 and 28, is also of no help. That case contains no consideration of the exclusion in §104(a)(2). Instead, the Court considered whether a backpay award to an employee under the National Labor Relations Act came within the definition of "wages" under the Social Security Act. It appears that counsel, and therefore the courts, simply assumed that the backpay in issue was "income," and focused only on whether the backpay was also included in the narrower subcategory, "wages." Neither this Court nor the court of appeals ever considered that the exclusions from the definition of "income" under the Internal Revenue Code — such as the one in §104(a)(2) — might also apply under the Social Security Act. *See also Nierotko v. Social Security Board*, 149 F.2d 273 (6th Cir. 1945),

aff'd, 327 U.S. 358 (1946).[3]

Nor can the Service garner current support for its two-tiered additional burden analysis from the lower courts. The appellate courts and the Tax Court, many of which once accepted the Service's approach, have now overwhelmingly rejected it. Those courts have overwhelmingly rejected any distinction between physical and nonphysical injuries or any additional inquiry into the nature of the recovery in a nonphysical injury case. Instead, those courts have concluded that, in reference to both physical and nonphysical personal injuries:

> [W]hether the damages received are paid on account of 'personal injuries' should be the beginning and end of the inquiry. To determine whether the injury complained of is personal, we must look to the origin and character of the claim and not to the consequences that result from the injury.

Threlkeld v. Commissioner, 87 T.C. 1294, 1299 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988). *Accord Downey v. Commissioner*, 97 T.C. 150 (1991)(age discrimination); *Metzger v. Commissioner*, 88 T.C. 834 (1987), *aff'd without published opinion*, 845 F.2d 1013 (3d Cir. 1988)(discrimination based on sex and national

[3] Subsequently, however, the courts have recognized, and the Service apparently agrees (*see* Petitioner's Brief at 10, n.5) that the §104(a)(2) exclusion also applies to Social Security taxes. As the courts have come to realize, "wages" is a subset of "income" for tax purposes. *Rowan Companies, Inc. v. United States*, 452 U.S. 247, 254 (1981); *Royster Co. v. United States*, 479 F.2d 387, 390 (4th Cir. 1973). If an item is excluded from "income" under §104(a)(2), then it is not taxable as "wages." *Anderson v. United States*, 929 F.2d 648, 654 (Fed. Cir. 1991); *Redfield v. Insurance Company of North America*, 940 F.2d 542, 548 (9th Cir. 1991).

origin);[4] *Rickel v. Commissioner*, 900 F.2d 655, 659 (3d Cir. 1990), *aff'g in part and reversing in part*, 92 T.C. 510 (1989)(age); *Pistillo v. Commissioner*, 912 F.2d 145, 148 (6th Cir. 1990), *rev'g* T.C. Memo 1989-329 (1989)(age); *Redfield v. Insurance Company of North America*, 940 F.2d 542, 545 (9th Cir. 1991)(age); *Wulf v. City of Wichita*, 883 F.2d 842, 872 & n.39 (10th Cir. 1989). *But cf. Thompson v. Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989)

[4] The Service cites (Petitioner's Brief at 25 & n.19) certain Tax Court decisions, including *Hodge v. Commissioner*, 64 T.C. 616 (1975), as supporting its position in this case. In fact, however, *Threlkeld* overruled the analysis used in *Hodge*. In *Metzger*, the Tax Court specifically ruled, following *Threlkeld*, that a violation of Title VII was a personal injury unde §104(a)(2). Subsequently, some Tax Court decisions deviated from the *Threlkeld* approach. *See Rickel*, 900 F.2d at 659, n.5 (analyzing the Tax Court's sometimes inconsistent approaches). However, the Tax Court's most recent opinion in *Downey* represented a reconsideration, *en banc*, of the Tax Court's approach. *Downey* reaffirms *Threlkeld* and overrules, either expressly or by implication, any of the Tax Court's decisions that looked to the consequences, rather than the nature, of a nonphysical personal injury.

(discussed *infra* at 21).[5]

In sum, as the majority of appellate courts and the Tax Court have come to recognize, the Service's distinction between physical and nonphysical injuries, and imposition of an additional burden on victims of nonphysical injuries, has no basis under §104(a)(2). Amici ask this Court to reject once and for all the Service's tortured and unfounded approach to this exclusion.

III. The Service's Interpretation of §104(a)(2) Unfairly Discriminates Against Victims of Nonphysical Personal Injuries.

Of particular concern to amici is the fact that the Service's strained interpretation of §104(a)(2) discriminates against victims of nonphysical personal injuries — such as plaintiffs who have been victims of race and sex discrimination. The Service's interpretation of §104(a)(2) adds a new wrinkle to this already complex area of litigation and operates to discourage and

[5] The Court of Appeals for the D.C. Circuit recently ruled, using a different analysis, that Title VII plaintiffs should be deprived of the §104(a)(2) exclusion. *Sparrow v. Commissioner*, No. 90-1151 (D.C.Cir. Nov. 26, 1991). The court erroneously focused on Title VII's backpay remedy and concluded that Title VII backpay could not be considered "damages" under §104(a)(2) because it was a remedy "in equity" and not damages "at law." This eccentric analysis would result in taxation of backpay only in cases brought under Title VII and not other statutes, thereby producing inconsistent results for victims of discrimination suing under different statutes, or even for a single victim of discrimination asserting a claim under more than one statute. Moreover, the D.C. Circuit's analysis ignores the Treasury Regulations, which define a "personal injury" by reference to the type of *right* violated ("tort or torttype right"), not the type of remedy. The Regulations also contradict *Sparrow*'s hypertechnical approach to the meaning of the term damages, stating only that damages "means an amount received." 26 C.F.R. §1.104-1(c). Finally, the D.C. Circuit's law-equity distinction ignores the fact that, at the time that §104(a)(2) was incorporated into the Internal Revenue Code of 1954, the distinction between actions at law and suits in equity in federal courts had long since been abolished by the 1938 Federal Rules of Civil Procedure. *See* Fed.R.Civ.P. 1 and 2 and Advisory Committee Notes.

complicate settlement of these cases. There is no basis in either tax policy or the civil rights laws for a two-tiered additional burden approach to victims of nonphysical personal injuries.

To the extent that §104(a)(2) excludes income which otherwise would be or should be subject to taxation, the Service's policy arguments must be addressed to Congress, which could act to narrow the §104(a)(2) exemption. The policy argument on the other side is, of course, that "the injured party, who has suffered enough, should not be further burdened with the practical difficulty of sorting out the taxable and nontaxable components of a lump-sum award." *Roemer v. Commissioner*, 716 F.2d 693, 696 (9th Cir. 1983). There is no basis, however, either in policy or in the current statutory language, for the Service's two-tiered additional burden approach. Victims of Title VII and other nonphysical injuries are not seeking special tax treatment, but simply treatment in accordance with that afforded other victims of personal injuries.

The Service argues that Title VII payments are based on compensation that plaintiffs otherwise would have received and that such compensation would have been taxable income. Petitioner's Brief at 19. This is equally true, however, in numerous recoveries in physical injury cases in which part, or even all, of a plaintiff's recovery is his lost past or future earnings. See, *e.g., Norfolk & W. Ry. v. Liepelt, supra*, 444 U.S. at 496. A victim who cannot work because he is black is no less barred from employment than a victim who cannot work because he is physically injured.

The Service also argues that its tax treatment is appropriate because, under Title VII, the only monetary relief available is backpay. Petitioner's Brief at 17. Thus, the Service apparently seeks to suggest that no "sorting out" of taxable and nontaxable amounts would be necessary in Title VII cases. The Service's facile approach, however, cannot mask the practical "sorting" problems that are inherent in the two-tiered additional burden approach.

In suits for injuries ranging from slander to defamation to age discrimination to race discrimination under 42 U.S.C. §1981, the Service's approach would require that both state and federal

courts apportion damages into various taxable and nontaxable components. Instead of simply excluding "any damages," as §104(a)(2) now provides, the Service would exclude only those damages that represent what the Service calls a "return of capital." At the very least, such an approach would necessitate special interrogatories and jury instructions to guide the apportionment of recoveries into taxable and nontaxable items.

Moreover, Title VII awards, too, would require sorting out. Under the Civil Rights Act of 1991, Title VII has been amended to provide for compensatory, as well as punitive, damages, including "emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other nonpecuniary losses." Pub.L. §102-166, 102(a)(1) and (b)(3)(to be codified at 42 U.S.C. §1981A). Even under the Service's additional burden approach, these kinds of compensatory damages would presumably be excluded under §104(a)(2), since they compensate for what the Service views as a prior loss of personal capital. *See* Petitioner's Brief at 12. Thus, apportionment, special interrogatories, and a maze of varying tax consequences will also be a part of litigation under Title VII.

Of even greater practical concern to amici, however, than the impact on litigation, is the impact of the Service's two-tiered additional burden approach on the potential for settlement of discrimination suits. By distinguishing between physical and nonphysical injuries and then placing an additional burden on taxpayers who have recovered for nonphysical injuries, the Service's approach adds both expense and complication to any potential settlement for such injuries. This result is particularly inappropriate under Title VII, in light of Congress' express policy of favoring voluntary compliance and settlement of such suits. *See Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 44 (1974); *Ford Motor Co. v. EEOC*, 458 U.S. 219, 228 (1982).

The position of the Service has made settlement of Title VII and other discrimination cases needlessly difficult and costly. When a chance exists that all or a portion of a settlement will be viewed by the Service as taxable income and "wages," a conservative defendant will take the position that income taxes and employment taxes must be withheld as a condition

of the settlement.[6] Defendants also point out that their true cost to settle includes the settlement amount *plus* those components of employment taxes that are not withheld from wages but are imposed directly on the employer as an excise tax.[7] These and many other tax issues can become huge factors in the settlement process, driving up the cost of settlement and forcing the plaintiff class to hire expensive tax professionals just to negotiate and administer the tax aspect of settlement of the case.

Complex allocation issues based on taxes will continue to plague the settlement process if this Court sustains the Service's position in this case. For example, it can be argued that Title VII recoveries represent not only "backpay" but also pre-judgment interest accrued since the time the discriminatory conduct occurred. While the Service says that backpay is subject to both income taxes and FICA/FUTA taxes, interest is clearly *not* subject to FICA/FUTA taxes, nor is it subject to income tax withholding by the defendant.[8] Thus, under the Service's current position, there are strong tax incentives to treat part of the settlement as pre-judgment interest in order to save the cost of FICA and FUTA taxes. Defendants worry, however, that the Service, on audit, may not respect the allocation to interest and may treat those dollars as if they were additional "wages," resulting in personal liability against the defendant for FICA/FUTA taxes, for income taxes not withheld, and for

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[6] The Federal Insurance Contribution Act (FICA) imposes Social Security and Medicare taxes on "wages." *See* 26 U.S.C. §3101 (tax imposed on individuals' income if such income constitutes "wages"); 26 U.S.C. § 3102 (collection of the employee's tax through withholding by the employer). Employers also must deduct and withhold the employee's income tax from "wages." 26 U.S.C. § 3402.

[7] *See* 26 U.S.C. §3111 (half of FICA tax imposed directly on the employer); 26 U.S.C. § 3301, *et seq.* (unemployment insurance tax imposed on employers by the Federal Unemployment Tax Act).

[8] *See e.g.*, Revenue Ruling 80-364, 1980-2 C.B. 294 (back pay is "wages," interest is not).

substantial penalties.[9] Negotiation of these matters is therefore a difficult and costly struggle for the parties. Moreover, the recent amendment of Title VII, discussed *supra* at 16, which expands the relief available under Title VII, will further complicate settlements, if the parties are required to engage in complex damage allocations acceptable to the Service.

To cite just one example of the tax-based complexity that plagues Title VII cases, about one-third of the lengthy settlement agreement in a recently settled class action, plus a five-page "side letter," deals solely or largely with tax matters.[10] The parties wrestled with such issues as (1) backpay vs. interest; (2) conditions under which the defendant would be willing to rely on the interest allocation and forego withholding and employment taxes; (3) the process for seeking a binding determination from the Service or an opinion of outside tax counsel prior to the distribution of money to the class members; (4) allocation of attorneys' fees and costs as between backpay and interest; (5) how a windfall to the defendant would be avoided where the employer's share of employment taxes was paid out of the settlement shares of the thousands of class members who were also current employees of the defendant; and (6) many other tax-related issues. Tax issues consumed countless hours of the parties' time and $80,000 was spent on tax counsel fees by the plaintiffs alone.

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[9] An employer who pays "wages" and does withhold income taxes or the employee's half of FICA taxes is personally liable for the amounts that should have been withheld but were not. *See* 26 U.S.C. §§3102(b) (FICA), 3403 (income tax withholding). The employer is also liable for (1) FUTA tax, (2) the employer half of FICA tax, and (3) a 10 percent penalty for failure to make a timely deposit of all required FICA/FUTA taxes and required income tax withholding. 26 U.S.C. §6656.

[10] *EEOC, et al. v. AT&T Technologies, Inc.*, No. 78 C 3951 and No. 82 C 1542 (N.D.Ill.) is a federal sex discrimination class action on behalf of approximately 13,000 women, alleging that the defendant carried out discriminatory policies against women taking maternity leaves from employment. The parties' settlement negotiations related to taxation issues began in earnest in February of 1991 and were not completed until July. The settlement was approved by the court on December 9, 1991.

In short, the Service's position, if adopted by the Court, would perpetuate drawn out and costly disputes in which plaintiffs attempt to characterize amounts of money as being one thing, in order to save the cost of taxes for both parties, and defendants, fearing tax liability, insist on the conservative position that all or much of the settlement consists of taxable "back wages," from which the Service is entitled to take its cut. Settlements are more expensive and tax issues may operate to discourage the parties from settlement, resulting in more protracted litigation. These costly and complex impediments to settlement would be eliminated if this Court simply gives §104(a)(2) its plain and intended meaning. Discrimination cases could then be settled just like any other personal injury case, without costly disputes over tax issues.[11] Discrimination victims would receive the same tax treatment as other tort victims.

IV. The Possibility that Plaintiffs' Recovery Here Was for "Work Performed" Provides No Basis for the Service's Position in this Case.

The Service repeatedly emphasizes that plaintiffs' recovery in this case was "for work already performed." Petitioner's Brief at 18-20, 21. The Service likens this to a suit for wage deficiencies or a wage differential. *Id.* at 5 (citing Opinion of the District Court, Pet. App. 32a). This characterization, however, even if it accurately describes the remedy provided in the case

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[11] If backpay for discrimination is not taxable, then the only arguably taxable items that could be recovered in such cases would be interest and, after 1991, punitive damages. Simplicity is best achieved, however, by holding that *all* amounts received (except punitive damages) are not taxable. Alternatively, the parties could treat a settlement as an amount of damages *without* interest. *See McShane v. Commissioner*, T.C. Memo 1987-151, 53 T.C.M. 409 (1987). However, this may require sophisticated consideration by the parties of the tax issues. Punitive damages are not an issue because they are simply not agreed to by defendants as part of settlements, even in cases where they could be awarded at trial.

before the Court,[12] cannot support the Service's general approach to Title VII and other nonphysical injury recoveries.

First, amici note that there is little basis for characterizing invidious wage discrimination as anything other than a personal injury. An employee who is paid less because she is female or black has been discriminated against and the wrong committed is to her person. *See* 42 U.S.C. §2000e-2(a). Compare 29 U.S.C. §206 (minimum wage requirements). In addition, a wage differential often forms one component of a physical injury case, where, for example, a physical injury requires a plaintiff to obtain a lower paying job because he can no longer perform a job he held prior to his injury. Presumably the Service would agree that this recovery would be excluded by §104(a)(2). Thus, neither the injury involved nor the remedy provided offers any basis for depriving plaintiffs here of the §104(a)(2) exclusion.

Moreover, to describe any backpay in a discrimination case as compensation "for services" is simply to mischaracterize the nature of the Title VII remedy. The backpay is not a liability that the employer incurred in order to obtain services. The reason for the payment of compensation is the employer's illegal discrimination, not the work the plaintiff performed.

More importantly, even if backpay could be viewed in some sense, in some cases, as "compensation for services" under Code §61(a)(1), this does not address the §104(a)(2) analysis. Items included in the general concept of income, or even specifically listed in §§61(a)(1) through (15), are included in "gross income" only "[e]xcept as otherwise provided in this subtitle," *e.g.*, except as otherwise provided in §104(a)(2).[13] The fact that damages

[12] Amici's understanding is that the settlement proceeds were not awarded or distributed on a backpay basis, nor was any attempt made to provide an appropriate differential to each plaintiff to provide her with a nondiscriminatory rate of pay. The specific nature of the award in this case, however, is most properly addressed by the parties.

[13] Other kinds of "compensation for services" are also excluded by "other provisions" of subtitle A, such as health insurance (§106). Similarly, other items specifically listed in §61(a) are, nevertheless, in some circumstances, excluded under another provision of subtitle A. *E.g.*, discharge of indebtedness income under §§61(a)(12) and 108.

received may also be viewed as "compensation for services," provides absolutely no support for the government's position.

However, even if a distinction is to be drawn in wage differential cases under §104(a)(2), the Service's proposed interpretation of that Section must still be rejected. After repeatedly stressing the fact that plaintiffs' recovery here was for work already performed, the Service argues that there is no distinction between salary discrimination cases and cases involving discriminatory firing or failure to hire. Petitioner's Brief at 26, n.20. The Service seeks a wholesale limitation on, and two-tiered additional burden approach to, all nonphysical injuries under §104(a)(2) and that approach must be rejected.

One court of appeals has drawn a distinction, under §104(a)(2), for a salary discrimination case, but on very narrow grounds. In *Thompson v. Commissioner*, 866 F.2d 709 (4th Cir. 1989), the Fourth Circuit held that a wage differential award under the Equal Pay Act of 1963, 29 U.S.C. §206(d), and under Title VII did not fall within the §104(a)(2) exclusion. The court reasoned that plaintiff "received compensation for services rendered whereas a tort plaintiff receives compensation for the inability to earn an income due to the tortious action of a defendant." 866 F.2d at 712. Amici respectfully disagree with the decision in *Thompson* for the reasons stated *supra* at 20-21. As other courts have recognized, however, even under the court's analysis in *Thompson*, recovery of backpay by a terminated employee or an employee who was not hired would still be excluded by §104(a)(2). *Redfield, supra*, 940 F.2d at 546; *Rickel, supra*, 900 F.2d at 664, n.16.

The government's disingenuous description of the recovery in this case — pay for "work performed" — should not be permitted to color this Court's analysis of the general nature of the "personal injury" of illegal discrimination. Cases involving illegal pay differences for "work performed" are a small fraction of the cases to which the Court's opinion in this case may be applied. Persons who are discharged, not hired, or not promoted to higher positions represent the bulk of discrimination victims. In the physical injury case there is no doubt that damages representing wages that should have been earned, but were not because of the injury, are excludable from tax. Victims of illegal discrimination are

in precisely the same position and are entitled to the same treatment.

By selecting this case as its vehicle for Supreme Court review, and by its description of the recovery as pay for work performed, the Service attempts to color the Court's analysis and, if the Court reverses, perhaps also to obtain a rationale for denying the benefits of §104(a)(2) to the more typical discrimination claimants who cannot be said, in any sense whatsoever, to be receiving pay for work performed. Amici respectfully request this Court to decline the Service's invitation to use this case as a vehicle for such an emasculation of the §104(a)(2) exclusion.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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In The

Supreme Court of the United States

October Term, 1991

UNITED STATES OF AMERICA,

Petitioner,

vs.

THERESA A. BURKE, et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF EQUAL RIGHTS ADVOCATES, INC., AS AMICUS CURIAE, IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICUS CURIAE

Equal Rights Advocates, Inc. ("ERA") is a San Francisco-based public interest legal and educational corporation dedicated to working through the legal system to secure equality for women. ERA has a long history of interest, activism, and advocacy in all areas of the law which affect equality between the sexes. ERA has been particularly concerned with equality in the work force because economic independence is fundamental to women's ability to gain equality in other aspects of society. As Title VII is one of the foremost federal laws designed to promote equality in the workplace and protect women from the devastation of discrimination, ERA has a particularly strong interest in the interpretation and implementation of Title VII through the courts. ERA considers the taxation of Title VII recoveries to be at odds with both the intent behind and the effectiveness of Title VII as a statute to remedy the harms of gender-based discrimination.

The consent of the parties to the filing of this *amicus curiae* brief have been received. Pursuant to Rule 37, Respondent has filed a general letter of consent with the Clerk of the Court, a copy of which is included herein. Likewise, the Solicitor General has filed a letter of consent with the Court, a copy of which is also included herein.

INTRODUCTION AND SUMMARY OF ARGUMENT

On October 30, 1991, Congress passed the Civil Rights Act of 1991. The act was thereafter signed by the

President and is now law. One of the principal "purposes" of the statute, as recited in its preamble, is "to provide *appropriate* remedies" for discrimination under Title VII. Those "appropriate" remedies now include the right to recover both "compensatory" and "punitive" damages "in addition to" any other forms of relief previously available. Civil Rights Act of 1991, Pub. L. No. 102-166, § 102(a)(1) (Nov. 21, 1991) (to be codified at 42 U.S.C. § 1981).

The passage of that statute, we submit, has overriding significance for this case in two respects. *First*, we believe that it should cause the Court to dismiss the writ of certiorari as improvidently granted. Not only has the unanticipated passage of the new act diminished the potential significance of this case, but it has, in all events, rendered it an inappropriate vehicle for attempting to adjudicate the broader tax issues raised by Title VII recoveries. *Second*, passage of the new act underscores the error in the government's analysis, which fatally confuses the nature of the right with the nature of the remedy. For good reason, the former should control the tax outcome under Internal Revenue Code section 104(a)(2). While that confusion would have been evident even without the new statute, its passage makes the point manifest.

ARGUMENT

I

THE WRIT SHOULD BE DISMISSED AS IMPROVIDENTLY GRANTED.

Given the limited resources of this Court, exercise of the discretionary power of review by certiorari is limited

to cases in which "there are special and important reasons" for granting the writ. *Rice v. Sioux City Cemetery*, 349 U.S. 70, 73 (1955) " 'Special and important reasons' imply a reach to a problem beyond the academic or the episodic." *Id.*

In light of these limits, the Court on occasion has elected to vacate a writ previously granted where intervening events make it apparent, for whatever reason, that the case should not be decided. *See, e.g., id.* Like the grant of certiorari, itself, no precise formula defines or controls the exercise of this prudential power. However, it has been used in the past where intervening legislation rendered a case of only "isolated significance." *Rice*, 349 U.S. at 76. *See also, Rudolph v. United States*, 370 U.S. 269, 270, *rehearing denied*, 371 U.S. 854 (1962) (where " . . . review [is] of no importance save to the litigants themselves . . . [t]he appropriate disposition is to dismiss the writ as improvidently granted."); *Cook v. Hudson*, 429 U.S. 165 (1976).

We submit that that course should be followed here. The petition for certiorari in this case was granted on October 29, 1991. At that time the case appeared to present (albeit in a somewhat unique factual context) a reasonable vehicle for resolving a split in Circuit Court opinions on the issue of the taxability of Title VII settlements. However, similar to the circumstances in *Rice*, after the writ was granted, the new Civil Rights act was signed into law. This act provides for compensatory damages in Title VII cases, thus dramatically altering the remedial landscape in future Title VII litigation.

The new statute should cause the writ in this case to be dismissed for two reasons. First, its passage renders the government's arguments effectively a dead letter in future cases. The essence of the government's position is that the "litigation benefits" provided for by the settlement agreement in this case are taxable because they *must*, given the limited nature of the relief sought *and available* under prior Title VII, represent solely back pay. Alternatively, the government appears to argue that the nature of the available monetary relief takes Title VII payments outside the broad ambit of "personal injury" recoveries which are excluded from income subject to tax under IRC section 104(a)(2). See pp. 6-9, *infra*.

Neither of those arguments survives the passage of the new act. Even the Internal Revenue Service has acknowledged that lump sum settlements of personal injury claims are entirely exempt even though the recoveries may include both compensatory damages and lost wages. Rev. Rul. 85-97, 1985-2 C.B. 50. No allocation is made between the two types of recovery for tax purposes. *See, e.g., Roemer v. Commissioner*, 716 F.2d 693, 696 (9th Cir. 1983). That is a settled practice in personal injury cases and the government nowhere challenges it in this case. That being so, passage of the new statute makes it a virtual certainty that the particular issue presented here – a "pure" back pay case – will arise, at best, with extremely episodic frequency in future Title VII litigation.[1]

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[1] In suggesting that the tax issue is effectively mooted by the new act, we do not mean to suggest that the government's

(Continued on following page)

In any event, passage of the new act so alters the jurisprudential calculus applicable to the Title VII tax issue that its consideration should, at the least, be postponed to a later day. The government's brief inexplicably all but ignores the new act. Yet if the government intends to continue to attempt to solve the nation's fiscal crisis out of the pockets of discrimination victims, it will need to do so with a wholly different set of arguments than the ones it advances here. In fact, at this juncture, it is unclear just what position it might advance.

It also may be that with passage of the new statute, the current division among the circuits will evaporate, rendering the problem moot. At a minimum, there is good reason to give both the taxing authorities and the

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(Continued from previous page)

position in this case is well-taken even under pre-existing law. As we explain in the next section of this brief, the basic thrust of the government's position is mis-conceived under pre-amendment Title VII as well as under the current law. *See* pp. 6-13, infra. Moreover, the argument that because former Title VII provided monetary recovery only in the form of "back pay" (itself an overstatement) any settlement must represent a taxable recovery of such wages is simply wrong. At the most basic level, settlements typically include some bargained for recovery of litigation expenses. More important, the remedies available under Title VII include various types of remedial benefits in the form of new work-rules or other procedures to ameliorate the effects of past violations. In a settlement, the extent and nature of those obligations become a bargaining chip, capable of being traded off for additional monetary payments. In a post-Coasian world it is therefore somewhat late as well as naive to suggest that a lump sum Title VII settlement necessarily represents simply "back pay."

lower courts an adequate opportunity to treat the consequences of the new law before having it decided by this Court. Certainly it would be "improvident" for this Court, in effect, to reach out to predetermine the consequences of a brand new law using the atypical (and now effectively historic) facts of this case as its vehicle. Two-hundred years of limiting adjudication to actual "cases and controversies" militates against that course.

One can envision tax issues that could arise under the new law. When and if they do, it may be appropriate for this Court to consider them. For the present, however, it should be sufficient to observe that at the time the government sought and was granted review in this case no one had reason to anticipate the passage of the 1991 Civil Rights bill, at least in its present form. That event having occurred, however, it is in the interest of all concerned for this Court to dismiss the present writ as having been improvidently granted.

II

IF THE COURT ELECTS TO DECIDE THE CASE, THE JUDGMENT BELOW SHOULD BE AFFIRMED.

In his seminal article on Justice Holmes, Benjamin Cardozo referred to the dangers inherent in the "tyranny of tags and tickets," that is, the danger of substituting law by catch phrase for reasoned analysis. Cardozo, *Mr. Justice Holmes*, 44 Harv. L. Rev. 682 (1931). We submit that the government's brief in this case falls victim to that vice and, thus, urges a result that neither language nor logic can support. Taking snippets from statutes, legislative history and cases, the government manages to confuse

both tax and civil rights principles in an effort to support a result which, in fact, is supported by neither.

A. WHEN AN AWARD IS RECEIVED AS A RESULT OF A PERSONAL INJURY IT IS EXEMPT FROM INCOME TAX.

The Government's brief purports to review the legislative and judicial history which led to the current taxation scheme in cases involving personal injuries. From that history it somehow derives the controlling principle that "[f]or Section 104(a)(2) to be applicable to a recovery involving a non-physical injury to personal rights, the taxpayer . . . has the burden of establishing that the recovery is reimbursement for a prior loss of personal capital and does not represent gain or profit that instead add[s] to [her] wealth." Gov. Br. pp. 14-15. Purporting to apply that principle, the government further argues that because the measure of monetary recovery for violation of Title VII is back pay, any settlement payments represent an enhancement of wealth that fall outside of Section 104(a)(2).

With all respect, the analysis is fundamentally confused. We assume for present purposes that the award in this case was "back pay."[2] We further acknowledge that Ms. Burke's wealth was enhanced when she received those payments so that what she received falls within recognized concepts of "income" as that term is used in Section 61(a) of the Internal Revenue Code. Indeed, in a broad sense, wealth necessarily is enhanced whenever

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[2] But see footnote 1, *supra*.

one receives money with no obligation to repay it. But the answer to the question before the Court does not rest on those matters at all, for not all "income" and not all "enhancements of wealth" are subject to our income tax. When an enhancement of wealth results from damage to one's personal rights, it is treated – as it has been since 1918 – as something that, as a policy matter, is not taxed.

The exemption established by Section 104 of the Code reflects a policy judgment that an individual does not profit (in an income tax sense) from receiving money as a result of being wronged from having his or her personal rights invaded – here, in the form of sex discrimination. The precise rationale for the section 104 exclusion has been expressed in various ways. According to one author:

> "Damage recoveries for injuries to the person or personal rights of the taxpayer are in a distinct class for income tax consideration. The underlying theory of the revenue service and the courts is that one does not make a profit from such judgments, but is compensated for personal harm. With this theory in mind, damage recoveries for physical inquiries are specifically exempted from taxation . . . although the recovery may include a replacement of earnings lost due to the injury."[3]

And another:

> "The tax treatment of personal injury recoveries under the Internal Revenue Code is based on public policy and not on strict tax logic. . . .

[3] Sheimer, *The Taxability of Judgments*, 4 UCLA L. Rev. 447, 448-49 (1957).

> Congress has exempted personal inquiry recoveries from gross income since 1918 and the same policy has been followed by the Internal Revenue Service. This reflects the humane desire not to burden those already injured, and the practical difficulty of segregating the taxable and nontaxable elements in a personal injury award, as most of these awards are in the form of unallocated sums."[4]

But whatever the rationale,[5] it is clear that the statute exempts from gross income damages resulting from personal injuries.

While the government at some points correctly articulates the relationship between Section 61(a) and Section 104(a)(2), its argument confuses the separate concepts of income and exemption. Section 61 includes in gross income all wealth enhancements unless specifically exempt. Here, Ms. Burke's wealth undeniably was enhanced by her recovery, but if the recovery meets the requirements of Section 104, it is exempt. *And whether the requirements of Section 104 are met depends not on the nature*

[4] Note, *Taxation of Damage Recoveries from Litigation*, 40 Cornell L. Rev. 345, 346 (1955).

[5] For comprehensive discussions of the rationale and issues involved in Section 104, *see also* Henry, *Torts and Taxes, Taxes and Torts: The Taxation of Personal Injury Recoveries*, 23 Hous. L. Rev. 701 (1986); Morgan, *Old Torts, New Torts, and Taxes: The Still Uncertain Scope of Section 104(a)(2)*, 48 La. L. Rev. 875 (1988); Palmer, *Internal Revenue Code Section 104(a)(2) and the Exclusion of Personal Injury Damages: A Model of Inconsistency*, 15 J. Corp. L. 83 (1989); Note, *Tax Treatment of Post-Termination Personal Injury Settlements*, 61 Cal. L. Rev. 1237 (1974).

of the recovery but on whether the amount received is on account of personal injuries or, as often articulated by the courts, on the nature of the taxpayer's injury.

B. THE NATURE OF THE HARM REDRESSED IN A TITLE VII ACTION IS A PERSONAL INJURY.

Title VII was enacted a quarter-century ago to redress widely-perceived problems of private employment discrimination on the basis of race, ethnicity, origin and gender. As various courts have recognized, such discrimination represents an "intentional assault on an individual's innermost privacy." *Bundy v. Jackson*, 641 F.2d 934, 945 (D.C. Cir. 1981). Being treated differently based on, *e.g.*, one's gender can result in impaired job performance,[6] loss of self-esteem, and an inability to integrate into the work environment.[7]

The government argues, however, that because the monetary remedy available under Title VII generally is limited to "back pay," any "injury suffered" by a Title VII claimant "was not a personal injury but rather an injury to economic interests." Gov. Br., p. 24. The argument is not only misconceived, but backward. The nature of the injury, not the allowable recovery therefore, determines the character of the claim. The fact that Congress originally specified certain forms of relief as appropriate to

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[6] Pierce, *Sexual Harassment and Title VII: A Better Solution*, 30 B.C.L. Rev. 1071, n.3 (1989).

[7] Minow, *Speaking of Silence*, 43 U. Miami L. Rev. 493, 499-500 (1988).

redress private employment discrimination does not alter the nature of the wrong.

What is more, it does substantial injustice to the terms of the statute to suggest that its remedial provisions were ever intended to be tightly cabined in the manner suggested by petitioner here. To the contrary, the relevant language of the statute as originally enacted provides that courts may order "reinstatment . . . with or without back pay . . . or any other equitable relief as the Court deems appropriate." 42 USC § 2000e-5(g). That language is consistent with the legislative history of the act which indicates a Congressional intention to deal broadly with the consequences of employment discrimination. This Court, similarly, has acknowledged that "the scope of relief under the Act is intended to make the victims of unlawful discrimination whole, and [that] the attainment of that objective rests not only upon the elimination of the particular unlawful employment practice complained of, but also requires that persons aggrieved by the consequences and effects of the unlawful employment practice be, so far as possible, restored to a position where they would have been were it not for the unlawful discrimination." *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 421 (1975), *citing* 118 Cong. Rec. 7168 (1972).

Given the type of harm resulting from discrimination based on race or gender, it is disingenuous to suggest that the "nature" of a Title VII claim can be determined by the form of monetary relief available to a successful claimant. However, if there were any prior doubt on that subject it is eliminated by the recently enacted additions to Title VII which now specifically permit a victim of discrimination to recover general compensatory damages. Pub. L. No.

102-166, § 102(a)(1). As recited in section 3 of the new statute, the purpose of this amendment is to provide "appropriate" remedies for discrimination. That statement of purpose is further elaborated by the legislative history of the act which expressly analogizes employment discrimination to other intentional torts, such as "assaults, batteries . . . and other intentional injuries to people." H.R. Rep. No. 102-40, Part I, 102nd Cong., 1st Sess., at 15 (1991). The report goes on to point out that the nature of the harms caused by racial, religious or gender discrimination include such matters as "humiliation, loss of dignity, psychological (and sometimes physical) injury . . . and other consequential injuries." *Id.* at 65.

The amended law thus puts to rest any serious claim that Title VII recoveries should be treated differently under Section 104(a)(2) than other forms of personal injury. At the most basic level, the availability of compensatory damages entirely undermines the government's technical argument that because Title VII did not previously provide for monetary relief other than back pay, no Section 104(a)(2) exemption is available.

More fundamentally, the new amendments knock the intellectual props out from under the government's attempt to determine the "nature" of a Title VII claim by reference to the remedy, rather than the right that is in issue. The change in the remedial provisions of Title VII to assure that "appropriate" relief is available was made without in any way altering the substantive provisions of Title VII that establish the nature of the wrong. But it is that wrong (and the types of harm foreseeably flowing therefrom) which defines the character of a Title VII claim

and – in accordance with established principles,[8] unchallenged by the government here – makes applicable the Section 104 exemption.[9]

Finally, we would note two additional points to underscore the appropriateness of the result reached below. First, the government's argument that excluding back pay damages will render a Title VII plaintiff "better off" than if she had never been discriminated against in the first place is not only irrelevant in light of the clear statutory policy but is, in any event, unpersuasive (and at least modestly offensive). It ignores the fact that the indelible effects of discrimination extend well beyond the reach of *any* form of compensation, whatever its nature or amount. In fact, the idea that money can ever make the victim of a serious tort "whole" is a fiction, necessary to the law but untrue in fact. While money is paid to tort victims as the only (or best) available surrogate for the harm visited upon them, few people would voluntarily trade an arm or leg for any amount of compensation.

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[8] *E.g., Pistillo v. Commissioner*, 912 F.2d 145, 150 (6th Cir. 1990); *Rickel v. Commissioner*, 900 F.2d 655, 661 (3d Cir. 1990); *Redfield v. Insurance Co. of North America*, 1991 U.S. App. LEXIS 17809 (9th Cir. 1991); *Threlkold v. Commissioner*, 87 T.C. 1294 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988).

[9] The fact that many future Title VII recoveries will continue to include damages for lost wages has no bearing on the tax issue here any more than it does in cases involving physical injuries or other torts, such as defamation, in which the injury is non-physical but the harm in part consists of lost professional opportunities. *See, e.g., Roemer v. Commissioner*, 716 F.2d 193; Rev. Rul. 85-97, 1985-2 C.B. 50. The government does not challenge these well-established principles of non-allocation in this case.

Equally few would exchange the right to be employed in a discrimination-free work environment for a tax-free damage award. The "better off" argument also ignores the important fact that litigation imposes heavy transaction costs and that most cases are settled at some compromise amount thus providing the plaintiff far less than the full amount he or she would have earned but for the challenged discrimination.

Second, from a policy standpoint, permitting Title VII recoveries to be excluded from income will facilitate the settlement of such litigation by permitting settlement payments to be received free from federal income tax. Further, it will avoid any perceived need to characterize or allocate components of a settlement as between "back pay" and other forms of recovery. Since many Title VII cases are brought as complex class actions, the potential benefit to over-crowded federal court dockets adds at least some additional weight to the more compelling arguments noted above.

CONCLUSION

For the foregoing reasons, the writ of certiorari in this case should be dismissed as improvidently granted. Alternatively, the judgment below should be affirmed.

Dated: December 23, 1991

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

UNITED STATES OF AMERICA,

Petitioner,

v.

THERESA A. BURKE, ET AL.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF AMICUS CURIAE OF THE UNITED AIR LINES PILOT GROUP IN SUPPORT OF RESPONDENTS

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IN THE

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UNITED STATES OF AMERICA,

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THERESA A. BURKE, ET AL.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF AMICUS CURIAE OF THE UNITED AIR LINES PILOT GROUP IN SUPPORT OF RESPONDENTS

INTEREST OF THE AMICUS CURIAE [1]

The United Air Lines Pilot Group is the informal designation for a group of approximately 85 former employees of United Air Lines, Inc., whose cases before the United States Tax Court present the common issue of taxation of settlement proceeds received under the Age Discrimination in Employment Act of 1967, 29 U.S.C. § 621 *et seq.* (the "ADEA").

[1] The parties have consented to the filing of this brief.

Shortly after the decision of the Tax Court in *Downey* v. *Commissioner*, 97 T.C. 150 (1991), the Tax Court granted a motion for summary judgment in favor of the taxpayer in the test case selected by the United Air Lines Pilot Group. *Keller* v. *Commissioner*, 62 T.C.M. 401 (1991). The Commissioner of Internal Revenue has obtained a stay of further proceedings before the Tax Court in *Keller* and related cases pending the disposition of the Government's action before the Supreme Court, on the ground that the tax treatment of the United Air Lines Pilot Group may be affected by either an affirmance or a reversal of the decision of the Sixth Circuit Court of Appeals.

SUMMARY OF ARGUMENT

The exclusion of personal injury damages from gross income does not distinguish among tort victims (or other persons asserting tort type rights) on the basis of whether their damages reflect lost earnings. Rather, it looks broadly to the nature of the injury by analogy to principles of tort and tort type laws.

No court has disagreed with the proposition that ADEA liquidated damages are excludable from gross income under Section 104(a)(2). Congressional reenactment of the statute at a time when courts were rejecting the Commissioner's attempt to tax ADEA liquidated damages implicitly confirms such excludability.

ARGUMENT

I. THERE IS NO BASIS FOR EXCLUDING TORT VICTIMS FROM COVERAGE BY SECTION 104(A)(2) MERELY BECAUSE THEIR DAMAGES ARE MEASURED BY A LOSS OF EARNINGS

Section 104(a)(2) of the Internal Revenue Code meets the requirement imposed by *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431, *rehearing denied*, 349 U.S. 925 (1955), that exemptions from taxation be supported by clear expressions of Congressional intent. Its language could not be plainer:

> [G]ross income does not include:
>
> . . .
>
> the amount of *any* damages received . . . on account of personal injuries. (Emphasis added.)

The plain meaning of a statute should not be disregarded except to prevent an absurd result or one that is contrary to legislative intent. *United States* v. *American Trucking Associations., Inc.*, 310 U.S. 534, 543 (1940).

The already broad statutory language of Section 104(a)(2) has been amplified by the regulations to include proceeds from the "prosecution of a legal suit or action based upon tort or tort type rights." 26 C.F.R. § 1.104-1(c).[2] No au-

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[2] Black's Law Dictionary defines "tort" broadly:

> A private or civil wrong or injury, other than breach of contract, for which the court will provide a remedy in the form of an action for damages.
>
> . . .
>
> A legal wrong committed upon the person or property independent of contract. *Black's Law Dictionary* 1335 (5th ed. 1979).

The breadth of tort law is an acknowledged feature of the English common law:

(Footnote continued on following page)

thority has suggested restricting Section 104(a)(2) to a snapshot of certain causes of action recognized as of 1918. On the contrary, by employing an evolutionary term derived from, but not confined to,[3] the common law, the Commissioner's regulations explicitly link the tax treatment under Section 104(a)(2) to a living, if not protean, body of law.[4]

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[2] *continued*

Tort obligations are in general obligations that are imposed by law—apart from and independent of promises made and therefore apart from the manifested intention of the parties—to avoid injury to others. By injury here is meant simply the interference with the individual's interest or an interest of some other legal entity that is deemed worthy of legal protection. Prosser and Keeton, *Law of Torts* (5th Ed. 1984) at 655.

[3] *Cf.* 26 C.F.R. § 1.104-1(c) ("tort or tort type rights"). Section 104(a)(2) extends beyond pure common law torts to statutory actions. *See, e.g., Roemer* v. *Commissioner*, 716 F.2d 693 (9th Cir. 1983) (codification of libel under California law); *Thompson* v. *Commissioner*, 866 F.2d 709 (4th Cir. 1989) (liquidated damages under the Equal Pay Act of 1963, 29 U.S.C. § 216(b)).

[4] New torts have arisen in the interval between the enactment of the predecessor of Section 104(a)(2) in 1918 and the taxable year in question. *See, e.g.*, Prosser and Keeton, at 60 (the intentional infliction of emotional distress by extreme conduct came into being "somewhere around 1930") and at 849 (scholars recognized the invasion of the right of privacy as developing in the early years of the 20th century). The same scholars identify a distinct modern trend of "economic retaliation," embracing tort-type injuries of employers to their employees. Prosser and Keeton, *supra*, at 1027.

The evolution of the concept of tort-type rights is not limited to actions under the common law, but includes statutory or legislative torts based on tort-type principles. *See, e.g.*, Prosser and Keeton at 1027, n. 24 (sex discrimination under Title VII and age discrimination under the ADEA cited as examples of statutory torts). *Cf. Schager* v. *Upjohn*, 913 F.2d 398 (7th Cir. 1990). In *Price Waterhouse* v. *Hopkins*, 490 U.S. 228, 264 (1989), Justice O'Connor likened "the statutory employment 'tort' created by Title VII" to the common law of torts.

The courts have adopted a straightforward definition of "personal injury" for purposes of Section 104(a)(2): any invasion of "the rights that an individual is granted by virtue of being a person in the sight of the law." *Rickel* v. *Commissioner*, 900 F.2d 655, 663, *quoting Threlkeld* v. *Commissioner*, 87 T.C. 1294, 1308 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988). Among the fundamental human rights recognized by courts construing Section 104(a)(2) are freedom of speech,[5] freedom from discrimination on the basis of sex[6] or age,[7] equal protection under the constitution,[8] and freedom from discrimination on the basis of national origin.[9] The Court of Appeals for the Sixth Circuit was adhering to this line of cases.

The Government offers no reasoned alternative to the courts' interpretation of the key statutory term, "personal injury." The essence of the Government's argument is that being treated unfairly in the workplace because of one's gender is in no sense an invasion of basic personal rights, but represents only a downward adjustment in an employment contract.

The revenue rulings on which the Government bases its position do not carry the force of law:

> Revenue rulings represent only the Commissioner's position concerning specific factual situations, rather than substantive authority for deciding a case in this Court. *Ashland Oil, Inc.* v. *Commissioner*, 95 T.C. 348, 360 (1990).

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[5] *Bent* v. *Commissioner*, 835 F.2d 67 (3d Cir. 1987).

[6] *Thompson*, *supra*; *Byrne* v. *Commissioner*, 883 F.2d 211 (3d Cir. 1989).

[7] *Rickel*, *supra*; *Pistillo*, 912 F.2d 145 (6th Cir. 1990); *Downey*, *supra*.

[8] *Madson*, 55 T.C.M. 1351 (1988).

[9] *Metzger*, 88 T.C. 834 (1987), *aff'd without published opinion*, 845 F.2d 1013 (3d Cir. 1988).

> This Court or any other court may adopt the conclusion and rationale of a revenue ruling; however, revenue rulings typically do not constitute substantive authority for a position, since "absent special circumstances, a revenue ruling merely represents the Commissioner's position with respect to a specific factual situation." *Rome I, Ltd.* v. *Commissioner*, 96 T.C. 695, 702 (1991), *quoting Tandy Corp.* v. *Commissioner*, 92 T.C. 1165, 1170 (1989), *citing Stark* v. *Commissioner*, 86 T.C. 243, 250-251 (1986).

Indeed, apart from their lack of precedential value, the announced legal positions of the Commissioner of Internal Revenue under Section 104(a)(2) and its predecessors are unreliable guides, because they show an unstable pattern of attempts to inject implied limitations into the statute.

The argument that personal injury encompassed only physical injuries was initially adopted, only to be quickly abandoned.[10] Punitive damages in personal injury actions have been subject to contradictory interpretations.[11] Despite the fact that liquidated damages under the Equal Pay Act, 29 U.S.C. § 206(d), and liquidated damages under the ADEA are authorized by the same provision in the Fair Labor Standards Act, 29 U.S.C. § 216(b), the Commissioner has attempted to characterize Equal Pay Act liquidated damages as the equivalent of interest on the

[10] *Compare* SM 957, 1 C.B. 65 (1919) (libel damages not excludable), *and* SM 1384, 2 C.B. 71 (1920) (damages for alienation of affections not excludable), *with* Sol. Op. 132, I-1 C.B. 92 (1922), *superseded by* Rev. Rul. 74-77, 1974-1 C.B. 33 (damages for alienation of affections excludable).

[11] *Compare* Rev. Rul. 58-418, 1958-2 C.B. 18 (punitive damages in libel suit taxable), *superseded by* Rev. Rul. 85-98, 1985-2 C.B. 50, *with* Rev. Rul. 75-45, 1975-1 C.B. 47 (certain punitive damages may be excludable under Section 104(a)(2)), *revoked by* Rev. Rul. 84-108, 1984-2 C.B. 32.

use of money, *see Thompson* v. *Commissioner*, 866 F.2d 709 (4th Cir. 1989), while attempting to cast ADEA liquidated damages as punitive damages, *see Rickel* v. *Commissioner*, 900 F.2d 655 (3d Cir. 1990). The Government's attempt in the case of taxpayer Burke to ignore the distinction between an injury and the measure of an injury has not always characterized the Commissioner's interpretation of the tax laws. As recently as 1983, the Commissioner of Internal Revenue was directly advising taxpayers:

> Amounts received for personal injury or sickness are not compensation for lost wages or profits, even *when measured by the amount of wages or profits that could have been earned* if not for the injury or sickness. IRS Publication 525, p. 11 (Rev. Nov. 1983). (Emphasis added.)

Such vacillating interpretations in the face of an essentially unchanged statute suggest result-oriented resistance to any novel application of Section 104(a)(2).[12]

In the case of taxpayer Burke, it is still not clear precisely what criterion is being advanced. The Government argues initially that the criterion for excluding Title VII damages is the fact that the damage measure is with reference to work that has already been performed. Pet. Br. 15-20. A later footnote then attacks the ADEA cases despite the fact that no work has been performed. *Id.* 26,

[12] No essential amendments were made in this aspect of Section 104(a)(2) or its predecessors until the Omnibus Budget Reconciliation Act of 1989, Pub. L. 101-239, § 7641(a), 103 Stat. 2106, 2379, which removed from the exclusion rule of Section 104(a)(2) punitive damages in cases not involving physical injuries, generally effective with respect to amounts received after July 10, 1989. For purposes of Section 104(a)(2), ADEA liquidated damages are compensatory and not punitive. *Rickel* v. *Commissioner*, 900 F.2d 655 (3d Cir. 1990).

n. 20. The rationale for treating ADEA and Title VII claimants alike—that back pay represents compensation for services that should have been paid but was not—conflicts with the Commissioner's announced positions on excludability of more traditional tort victims' lost earnings damages.

The Government would apply Section 104(a)(2) to employees who by tortious action have been denied the opportunity to profit from work. Rev. Rul. 85-98, 1985-2 C.B. 50. But the emphasis on total incapacity to work suggests that the Government would introduce into the statute a implicit limitation that would exclude from the category of personal injury damages any amounts measured by wage differentials attributable to reduced ability, even though such differentials may have been caused by tortious action. There is no basis in tort law for making distinctions between the tort victim who loses a job and the tort victim who stays employed but loses the opportunity to earn extra wages, such as the defamed employee who is denied a promotion[13] or the negligently injured employee who is prevented from working overtime[14] or prevented from moving to a higher paying job.[15] The tort is the same, although the measure of damages may vary.[16]

[13] *Cf. M. Rosenberg & Sons* v. *Craft*, 182 Va. 512, 29 S.E.2d 375, (1944) (insufficient evidence was found to support the otherwise acknowledged cause of action).

[14] *Tijerina* v. *Cornelius Christian Church*, 273 Or. 58, 539 P.2d 634 (1975).

[15] *Missouri Pacific Railroad Co.* v. *Harelson*, 238 Ark. 452, 382 S.W.2d 900 (1964).

[16] The Government's reliance on the concepts of past services and hypothetical services reintroduces in another guise a dichotomy, now rejected by the courts, between damages to personal reputation and damages to professional reputation. *See Threlkeld* v. *Commissioner*, 848 F.2d 81 (6th Cir. 1988); *Roemer* v. *Commissioner*, 716 F.2d 693 (9th Cir. 1983).

Therefore, there can be no justification under Section 104(a)(2), whose regulations invoke "tort or tort type" standards, for distinguishing between an individual whose damage measure reflects complete inability to work and one whose damage measure reflects only partial capacity.

II. THE COURT SHOULD RESIST THE GOVERNMENT'S SUGGESTION TO EXTEND ITS ANALYSIS OF THE TAXPAYERS' CASE TO ADEA CLAIMANTS NOT BEFORE THE COURT

The Court should resist the Government's invitation to resolve the case of the taxpayers in a manner that extends to other classes of claimants whose cases are not under consideration. Denying the benefits of Section 104(a)(2) to ADEA victims leads immediately to inconsistencies, for there is no principled way of preventing the same theory from reaching any tort victim whose damages are measured by lost or reduced earnings.

Age discrimination is recognized to be a personal injury within the meaning of Section 104(a)(2).[17] Only a portion of ADEA damages reflects earnings-based remedies; the remainder encompasses liquidated damages, fringe benefits, insurance benefits, pension benefits, and retirement benefits. 29 U.S.C. § 626(b). The two principal forms of damages received under the ADEA, lost earnings and liquidated damages, have been held excludable from income.[18]

[17] *Pistillo* v. *Commissioner*, 912 F.2d 145 (6th Cir. 1990); *Rickel* v. *Commissioner*, 900 F.2d 655 (3d Cir. 1990); *Downey* v. *Commissioner*, 97 T.C. 150 (1991); *Keller* v. *Commissioner*, 62 T.C.M. 401 (1991); *see also, Redfield* v. *Ins. Co. of North America*, 940 F.2d 542 (9th Cir. 1991).

[18] Other elements of ADEA damages do not appear to have been litigated, but under controlling precedent would similarly be excludable under Section 104(a)(2).

The Commissioner of Internal Revenue unsuccessfully argued for inclusion of lost earnings damages on the theory that such amounts were contractual in nature. *Rickel, supra.* The argument in favor of inclusion of liquidated damages contended that the latter were punitive damages for purposes of Section 104(a)(2). *Downey, supra.* The courts are now uniform in their rejection of these attempts by the Commissioner.

Whether ADEA liquidated damages are considered to have a compensatory or a punitive element for non-tax purposes[19] is not determinative of their characterization under the Internal Revenue Code. The Tax Court has stated unequivocally that ADEA liquidated damages are not punitive for purposes of Section 104(a)(2).[20]

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[19] *Compare Trans World Airlines, Inc.* v. *Thurston*, 469 U.S. 111 (1985), with *Overnight Motor Transp. Co., Inc.* v. *Missel*, 316 U.S. 572, 583-584 (1942), where the Court stated:

> [L]iquidated damages . . . are compensation, not a penalty or punishment by the Government. [citations omitted] The retention of a workman's pay may well result in damages too obscure and difficult of proof for estimate other than by liquidated damages.

In *Brooklyn Savings Bank* v. *O'Neil*, 324 U.S. 697, 707 (1945), the Court explained:

> [The award of liquidated damages] constitutes a Congressional recognition that the failure to pay . . . on time may be so detrimental to maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers and to the free flow of commerce, that double payment must be made in the event of delay in order to insure restoration of the worker to that minimum standard of well-being.

[20] *Rickel, supra.* Punitive damages received in connection with personal injuries have been held includable in income only where they serve no compensatory purpose. *Miller* v. *Commissioner*, 914 F.2d 586, 591 (4th Cir. 1990) (distinguishing *Thompson, supra*, where the same court had held excludable under Section 104(a)(2) damages considered to serve deterrent and compensatory purposes).

Reenactment of a statute by Congress without substantial change should be construed as implicit Congressional approval of prevailing interpretations. *Provost* v. *United States*, 269 U.S. 443 (1926). In 1989, when it was apparent that courts were rejecting the Commissioner's litigating positions with respect to Section 104(a)(2), Congress considered several proposed statutory amendments. A bill introduced in the House of Representatives would have allowed the benefits of the exclusion rule of Section 104(a)(2) only with respect to personal injuries in cases involving physical injury or physical sickness.[21] The amendment that was eventually passed by Congress removed the protection of Section 104(a)(2) only with respect to punitive damages in cases not involving physical injury or physical sickness.[22] In 1989 Congress was presumptively[23] aware not only of the judicial interpretations in *Thompson* and *Rickel* treating Equal Pay Act and ADEA liquidated damages as excludable damages for personal injuries, but also of the unsuccessful administrative interpretations of such damages as taxable.

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[21] H.R. 3299, § 11641, introduced on September 20, 1989. The amendment was intended to reverse the burgeoning trend in the case law toward tax-free treatment in employment discrimination, among other areas. *See* H.R. Ways and Means Committee, *Revenue Reconciliation Bill of 1989, Explanation of the Revenue Provisions*, 238 (September 14, 1989).

[22] "[Section 104(a)(2) shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness." 26 U.S.C. § 104(a) (final sentence). *See* H.R. Conf. Rep. No. 386, 101st Cong., 1st Sess. 622-23, *reprinted in* 1989 U.S. Code Cong. & Admin. News 3225-26.

[23] *Cf. Lorillard* v. *Pons*, 434 U.S. 575, 580 (1978).

CONCLUSION

The Court should reaffirm the definition of personal injury that has guided the courts in construing Section 104(a)(2) and should reject the Government's unwarranted distinctions among classes of tort victims based partly on the measure of their injuries. Any fundamental distinctions proposed to be introduced into this law should be adopted only after due legislative and regulatory process.

Respectfully submitted,

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No. 91-42

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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1991

UNITED STATES OF AMERICA,
Petitioner,

v.

THERESE A. BURKE, ET AL.,
Respondents.

On Writ of Certiorari from the United States Court of Appeals for the Sixth Circuit

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AMICUS CURIAE BRIEF OF NATIONAL EMPLOYMENT LAWYERS ASSOCIATION IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether payments received in settlement of claims under Title VII of the Civil Rights Act of 1964 are excluded from the claimant's gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness." (26 U.S.C. 104(a)(2)).

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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1991

No. 91-42

UNITED STATES OF AMERICA, PETITIONER,

v.

THERESE A. BURKE, ET AL.,
RESPONDENTS.

On Writ of Certiorari from the United States Court of Appeals for the Sixth Circuit

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**BRIEF OF
NATIONAL EMPLOYMENT LAWYERS ASSOCIATION
AS AMICUS CURIAE**

The National Employment Lawyers Association, with the written consent of the parties, respectfully submits this brief as Amicus Curiae in support of the

Respondents. The letters of consent have been filed with the Clerk of the Court.

INTEREST OF AMICUS CURIAE

Amicus urges the Court to follow the well established nature of the claim test in interpreting section 104(a)(2) of the Internal Revenue Code, and to thus affirm the holding of the Sixth Circuit that awards and settlements in statutory employment discrimination cases are excludable from gross income as damages received on account of personal injuries.

The National Employment Lawyers Association ("NELA"), formerly the Plaintiff Employment Lawyers Association, is a voluntary organization of over 1,200 attorneys who specialize in the representation of the individual

in controversies arising out of the workplace. NELA has devoted itself to supporting remedial civil rights legislation in Congress, and in the state and federal courts. NELA's membership and its governing body is composed of experts in state and federal equal employment opportunity statutes as well as wrongful discharge law. NELA has a direct interest in the law governing the construction and application of the civil rights statutes as NELA members' clients litigate under these statutes regularly. NELA is well-qualified to brief the Court on the implications of its decision in this case, having participated as amicus curiae in numerous other cases involving the employment discrimination laws. See, e.g., Caterpillar, Inc. v.

Williams, No. 86-526 (Oct. 1986 Term); Harbison -Walker Refractories Inc. v. Brieck, No. 87-271 (Oct. 1987 Term); English v. General Electric Co., No. 89-152 (Oct. 1989 Term); Cooter & Gell v. Hartmarx Corp., No. 89-275 (Oct. 1989 Term).

ARGUMENT

AN AWARD OR SETTLEMENT UNDER TITLE VII OF THE CIVIL RIGHTS ACT CONSTITUTES DAMAGES RECEIVED "ON ACCOUNT OF PERSONAL INJURIES" WITHIN THE MEANING OF SECTION 104(a)(2) OF THE INTERNAL REVENUE CODE

Introduction

This Court's focus should be on the nature of the claim for which compensation is being received by the taxpayer, not the harm or consequences of the alleged wrongdoing. Adhering to this proper focus, the Court must determine whether a statutory employment

discrimination claim seeks redress for personal injuries or otherwise. In Goodman v. Lukens Steel Co., 482 U.S. 656 (1987), the Court held that a claim for employment discrimination under 42 U.S.C. Sec. 1981 "is a fundamental injury to the individual rights of a person." 482 U.S. at 661. Claims for employment discrimination pursued under Title VII of the Civil Rights Act of 1964, like those before the Court in the case sub judice, should be treated no differently. Such claims arise under a law whose purpose "is to promote . . . a deeper respect for human dignity."[1]

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[1] Remarks of President Lyndon B. Johnson on July 2, 1964 upon the signing of the Civil Rights Act of 1964, reprinted in Charles and Barbara Whalen, "The Longest Debate: A Legislative History of the 1964 Civil Rights Act" 232 (1985).

Thus, awards and settlements in statutory employment discrimination cases should be excluded from gross income as damages received on account of personal injuries. Any other result would increase transactional costs and diminish the prospects of settlement -- a result that would be inconsistent with the strong legislative directive that efforts be made to conciliate such disputes.

A. Application of Section 104(a)(2) requires the Court to focus on the nature of the Respondents' claim

Section 61(a) of the Internal Revenue Code of 1954 (26 U.S.C.) provides that, except as otherwise provided in the Code, gross income means "all income from whatever source derived." Accordingly, any funds or other accessions to wealth received by a

taxpayer are presumed to be gross income, unless the taxpayer can demonstrate that the accession fits into one of the specific exclusions created by other sections of the Code. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 430-431 (1955).

The exclusion at issue here is found in Section 104(a)(2) of the Code, which provides that gross income does not include "the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness." This exclusion remains substantially the same as its original predecessor which was enacted as part of the Revenue Act of 1918, Pub. L. 65-254, Ch. 18, section 213(b)(6), 40 Stat. 1057, 1065-66. While Congress has failed to ever precisely define the

phrase "personal injuries or sickness,"[2] it has chosen to retain the exclusion through its numerous overhauls and reforms of the Internal Revenue Code.[3]

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[2] Neither the legislative history of the Revenue Act of 1918, H. Rep. No. 767, 65th Cong., 2d Sess. (1918) 1939-1 C.B. (Part 2) 86, 92, nor that of the Internal Revenue Code of 1954, H. Rep. No. 1337, 83d Cong., 2d Sess. 15 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 15-16 (1954) contains any such definition.

[3] In 1989, the Treasury Department proposed that IRC § 104(a)(2) be amended to permit only damages for physical injury to be excluded from income. Under the Department's proposed amendment, damages for nonphysical torts would have been no longer excluded from income taxation. The Department's proposal was rejected. The Conference Report stated as follows:

> Under present law, damages recovered on account of personal injury are excluded
>
> (continued...)

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[3](...continued)

> from gross income. In some cases, courts have held that this exclusion is available even though there is no physical injury, for example, in cases involving employment discrimination.
>
> Conference Report to accompany H.R. 3299, Omnibus Budget Reconciliation Act of 1989, H.R. Report No. 101-386, 101st Cong., 1st Sess. 622 (November 21, 1989). See also Report of the Committee on the Budget of House of Representatives to accompany H.R. 3299, Omnibus Budget Reconciliation Act of 1989, H.R. Report No. 101-247 101st Cong., 1st Sess. 1354-55 (Sept. 20, 1989):
>
> > "Under present law, gross income does not include any damages received . . . on account of personal injuries or sickness." (Sec. 104)). Courts have interpreted this exclusion broadly in some cases to cover awards for personal injury that do not relate to a physical
> >
> > (continued...)

The Treasury Regulations amplify the section 104(a)(2) exclusion by defining "damages received on account of personal injuries" to mean "an amount received . . . . through prosecution of a legal suit or action based upon tort or tort-types rights, or through a settlement entered into in lieu of such prosecution." Treas. Reg. section 1.104-1(c). This Regulation indicates that the excludability of damages depends

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[3](...continued)
injury or sickness. For example, some courts have held that the exclusion applies to damages in cases involving employment discrimination ...".

Cf. Lorillard v. Pons, 434 U.S. 575, 580 (1978) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change.")

upon the nature and origin of the underlying claim. The Tax Court has historically stated that the correct test in determining whether damages fall within the section 104(a)(2) exclusion is tc look to the origin of the claim. See, e.g., Glynn v. Commissioner, 76 T.C. 116, 119 (1981), aff'd, 676 F.2d 682 (1st Cir. 1982); Seay v. Commissioner, 58 T.C. 32 (1972); McDonald v. Commissioner, 9 B.T.A. 1340 (1928). In application, however, the Tax Court has frequently deviated from its own test and has looked to the consequences of a tort or tort-type claim rather than the origin of the claim.

While the Tax Court has interpreted the exclusion to cover compensatory damages for both physical and

nonphysical injury to the person, Church v. Commissioner, 80 T.C. 1104, 1106 (1983), in cases involving nonphysical injury the Tax Court, until recently, has held that only those damages which actually reimburse for such nonphysical personal injury, as opposed to damages paid for earnings lost because of such injury, are excludable under section 104(a)(2) of the Code. See, e.g., Roemer v. Commissioner, 79 T.C. 398 (1982), rev'd, 716 F.2d 693 (9th Cir. 1983) (holding that compensatory damages received in libel suit for injury to professional reputation were includable in gross income); compare Church v. Commissioner, 80 T.C. 1104 (1983) (damages received by Arizona attorney general in defamation suit were for injuries to his personal reputation and

therefore excludable under section 104(a)(2)).

The validity of the Tax Court's approach in examining the consequences stemming from a tortious action, instead of focusing on the origin of the claim, in the case of a nonphysical injury was first questioned by the Second Circuit in its review of Agar v. Commissioner, 290 F.2d 283, 284 (1961), aff'g, 19 T.C.M. (CCH) 116 (1960). Thereafter, the Court of Appeals for the Ninth Circuit reversed the Tax Court's position in Roemer, pointing out that when an individual recovers a lump-sum award for a physical personal injury the entire award is properly excluded under section 104(a)(2) even when the predominant result of the injury is loss of income, and concluded that any

different approach for a nonphysical injury -- such as defamation -- would be illogical. Roemer, 716 F.2d at 697. The Roemer court held that all compensatory damages, however computed, in a claim alleging a personal tort were excludable under section 104(a)(2) of

the Code.[4] The Roemer court stated the

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[4] In response to the Ninth Circuit's opinion in Roemer, the Internal Revenue Service issued Rev. Rul. 85-143, 185-2 CB 55, stating that it would continue to follow the rationale of the Tax Court's Roemer opinion, distinguishing between injury to personal reputation and business reputation.

The Tax Court in Roemer also held that the entirety of the punitive damage award was taxable. The Ninth Circuit overturned this holding, stating that when Congress enacted section 104(a)(2) to make tax-free "any damages" arising from personal injury, this meant all damages, including punitive damages. Several years later, the Tax Court, sitting en banc, ruled in a 14-2 decision that punitive damages under section 104(a)(2) are excludable. Miller v. Commissioner, 93 TC 330 (1989). Thereafter, the Fourth Circuit reversed the Tax Court's holding. Commissioner v. Miller, 914 F.2d 586 (1990). The rationale of the Fourth Circuit was that punitive damages serve no compensatory function. This rationale is squarely contrary to the Ninth

(continued...)

rule thusly:

> The nonpersonal consequences of a personal injury, such as a loss of future income, are often the most persuasive means of proving the extent of the injury that was suffered. The personal nature of an injury should not be defined by its effect.

716 F.2d at 699.

In Bent v. Commissioner, 87 T.C. 236 (1986), aff'd, 835 F.2d 67 (3d Cir. 1987), Judge Chabot of the Tax Court, without discussing Roemer, reached a result identical to that reached by the Ninth Circuit. The decision held that damages, measured primarily by lost wages, paid to a professor in settlement of a claim brought under 42 U.S.C. section 1983 for violation by a local

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[4](...continued)
Circuit's in Roemer. See also Keller v. Commissioner, 62 T.C.M. (CCH) 401 (1991).

school district of the petitioner's First Amendment right to freedom of speech, were excludable under section 104(a)(2) of the Code. This result was reached after a review of various Supreme Court decisions discussed therein which held that section 1983 creates a species of tort liability for personal injury. In affirming the Tax Court, the court of appeals rejected the Commissioner's argument that because the settlement received by Bent contained an amount based upon his lost wages, that sum was compensation not excludable under section 104(a)(2), stating "an award of damages for the violation of a constitutional right may be measured in whole or in part by the amount of lost wages." Bent, 835 F.2d at 70.

Finally, in Threlkeld v. Commissioner, 87 T.C. 1294 (1986), aff'd, 848 F.2d 81 (6th Cir. 1988), a decision reviewed by the full Tax Court, that Court announced by a vote of 15 to 1 that it was abandoning the position it had taken in Roemer and other cases, i.e., that the consequences of a nonphysical personal injury (such as damage to personal reputation as opposed to professional reputation) determine excludability under section 104(a)(2). Rather, the Tax Court held that the sole basis for excludability will be whether the claim for which the damages are paid, however, such damages are computed, is one for personal injury.[5]

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[5] This test for excludability under section 104(a)(2) which is adopted in the Regulations is consistent with the "origin of the claim" inquiry (continued...)

In Threlkeld, the Tax Court held that damages awarded in a claim for malicious prosecution under state law were excludable under section 104(a)(2) even though they were paid for damage to professional reputation because malicious prosecution is a tort claim for personal injury under state law.

The Tax Court specifically discussed the inappropriateness of distinguishing between personal and professional damages in personal injury cases involving nonphysical injury whereas it had never made such a

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[5](...continued) developed by the Supreme Court for determining the tax treatment of certain items; see e.g., Arrowsmith v. Commissioner, 344 U.S. 6 (1952); Woodward v. Commissioner, 397 U.S. 572 (1970); United States v. Hilton Hotels Corp., 397 U.S. 580 (1970).

distinction in cases involving physical injury. Threlkeld, 87 T.C. at 1300-1301. And, after noting that the beginning and the end of the inquiry should be whether damages received are paid on account of "personal injuries", 87 T.C. at 1299, the court stated

> In conclusion, we emphasize that the question of interpretation presented by the language of section 104(a)(2) presents conceptual challenges. We also recognize that focusing upon the nature of the taxpayer's injury instead of the nature of the consequences flowing from that injury will often be difficult. However, this is no more difficult in most cases than the type of inquiry previously required by the line of cases, culminating in Roemer, which distinguished the nature of the consequences resulting from a claim. Furthermore, the approach that we will now apply in all cases, whether the injury claimed is personal, more accurately reflects the inquiry required by the plain meaning of the statute. Exclusion under section 104

> will be appropriate if compensatory damages are received on account of any invasion of the rights that an individual is granted by virtue of being a person in the sight of the law.

The fact that the recovery in a tort-type case is, in whole or in part, of monies that should have been paid for work actually performed is not a reasoned basis for treating the recovery as taxable. Once again, such an analysis focuses on the nature of the recovery and not the nature of the wrong being redressed which is the proper focus. Thus, the Court should reject cases like Bowman v. United States, 824 F.2d 528 (6th Cir. 1987) and Thompson v. Commissioner, 866 F.2d 709 (4th Cir. 1989), which focus on the fact that the recovery was for work actually performed. Rather, it is the Third

Circuit that had it right in Byrne v. Commissioner, 883 F.2d 211, 214 (1989), when it stated:

> The relevant inquiry ... is whether the settlement was received on account of personal or non-personal injuries, not whether the damages compensate the taxpayer for economic losses.[6]

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[6] In Byrne, the Third Circuit held that all of the damages arising from settling claims for breach of the federal Fair Labor Standards Act and for wrongful discharge under New Jersey law - not just part of them - were tax-free personal injury damages. In her complaint to the Equal Employment Opportunity Commission, Ms. Byrne alleged that she had been fired for reporting discriminatory compensation practices. She recovered a $20,000 settlement, of which the Tax Court allocated half to taxable lost wages resulting from the firing. On appeal, the Third Circuit upheld Ms. Byrne's argument that, although her damages were a fraction of lost income, they should be excluded under section 104(a)(2).

B. The violation of one's statutory right to be free of invidious employment discrimination gave rise to a claim for personal injury

The Government argues that the respondents' claim is merely a claim that their economic interests have been injured. Its argument ignores the realities of discrimination that are well known to this Court. Discrimination -- to be treated differently because of one's gender or one's race -- is an affront to human dignity. Here, the Court is confronted with a classic case of biased stereotypical thinking -- male employees are worth more than female employees. Such prejudice not only deprives female employees of their true worth in terms

of salary, it also is an insult to them as individuals.[7]

The Supreme Court has consistently held that the constitutional right to be free of sex discrimination is a personal right. Cannon v. University of Chicago, 441 U.S. 677, 691 n. 13 (1979). Gender discrimination, which both the Equal Pay Act and Title VII were enacted to redress, was analyzed in detail by the Court in Davis v. Passman, 442 U.S. 228 (1979). In Davis, the Court held that the equal protection component of the Due Process Clause of the Fifth

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[7] This Court has emphasized that "[t]he principal focus of the statute is the protection of the individual employee ..." Connecticut v. Teal, 457 U.S. 440, 455 (1982). See also Furnco Construction Co. v. Waters, 438 U.S. 567, 579 (1978); Los Angeles Dept. of Water & Power v. Manhart, 435 U.S. 702, 708 (1978).

Amendment to the Constitution provides federal congressional employees a federal constitutional right to be free of gender discrimination in employment. The Court described the right as personal, stating "it is petitioner, after all, who must suffer the effects of such discrimination." 442 U.S. at 235 n. 10 (citations omitted). And, as the Tax Court reasoned in its decision in Thompson v. Commissioner, "[s]ince the right to be free from gender or sex discrimination is a personal right as the Supreme Court has held, it follows that payments of damages made for violation of that right are damages for personal injuries." 89 T.C. at 649. See also Bivens v. Six Unknown Narcotics Agents, 403 U.S. 399 (1971) (violation of the Fourth Amendment right to be free

of unreasonable search and seizure compared to the common law tort of trespass and held to be actionable in damages); Wulf v. City of Wichita, 883 F.2d 842, 872-73 (10th Cir. 1989) (court, focusing on the nature of the claim, held that a settlement award in a civil rights action for wrongful discharge in violation of the First Amendment was nontaxable).

The injuries suffered by respondents are similar to those incurred by the petitioner in Metzger v. Commissioner, 88 T.C. 834 (1987), aff'd mem., 845 F.2d 1013 (3d Cir. 1988). Metzger, an associate professor of Spanish, had been denied tenure and had her teaching contract terminated. She filed various state and federal claims in various fora, including a Title VII

claim, alleging breach of contract and violation of her constitutional and statutory rights to be free from discrimination based on her gender and national origin. Metzger settled her claims for $75,000, half of which was designated in the settlement agreement as wages for federal income tax withholding purposes only. Metzger excluded the balance from her income under section 104(a)(2) as damages for personal injuries.

The Tax Court upheld this exclusion, stating that the majority of the settled claims (i.e., her discrimination claims) were tort or tort-type claims and that at least the amount excluded by Metzger constituted damages on account of personal injuries. 88 T.C. at 858. See also, Melani v. New

York City Board of Education, 652 F.Supp. 43 (S.D.N.Y. 1986) (those portions of amounts paid in settlement of a class action sex discrimination suit which are allocable to 42 U.S.C. section 1983 claims are excludable under section 104(a)(2)); Bent, 835 F.2d 67 (damage award for the violation of the right to freedom of speech -- a constitutional right -- constitutes damages for personal injury).

The right to be free from gender discrimination is a personal statutory right. Thus, just as violation of First Amendment rights causes personal injury, Bent, 835 F.2d 67, so must violation of this right to live and work without being disadvantaged solely by reason of gender. The injury suffered by respondents as victims of sex

discrimination is personal; its character does not vary according to the statutory schemes available to them for the injury's redress. In Johnson v. Railway Express Agency, Inc., 421 U.S. 454, 457-61 (1975), the Court, in comparing 42 U.S.C. § 1981 to Title VII, concluded that the nature of the injuries suffered under both statutes are essentially the same. See Metzger, 88 T.C. at 856 (discussing Johnson).

Absent proof of sex discrimination, respondents would not have received the wage differential award. For this reason, this case is distinguishable from the express or implied contract cases in which a factual determination was made that an amount was intended to settle a contract claim rather than a tort or tort-type claim. See, e.g.,

Agar, 290 F.2d 283 (2nd Cir. 1961) (claim for additional compensation for years of service); Glynn, 76 T.C. 116 (payment for accrued sick leave); Knuckles v. Commissioner, 23 T.C.M. (CCH) 182 (1964), aff'd, 349 F.2d 610 (10th Cir. 1965) (payment in settlement of employment contract claim). Employment discrimination claims are tort-type claims; whereas, common law claims for breach of employment contract, written or implied, are not. Awards and settlements under the former are non-taxable; whereas those for breach of an employment contract are taxable. Thus, one who pursues a claim for breach of implied contract based on an employer's employee manual and receives monies in a judgment or

settlement thereof must include that amount in gross income.

In addition, the position that claims of discrimination under Title VII are tort-type claims is reinforced by the decision of the Third Circuit Court of Appeals in Byrne v. Commissioner, 883 F.2d 211 (3d Cir. 1989). In Byrne, one of the claims raised was that the plaintiff's employer violated the retaliation provision (section 215(a)(3) of the Fair Labor Standards Act (FLSA), 29 U.S.C. § 215(a)(3)) by allegedly discharging her because she cooperated in an EEOC investigation of alleged Equal Pay Act (EPA), 29 U.S.C. § 206(b), violations. Under section 216(b) of the FLSA, 29 U.S.C. § 216(b), the remedies for violating section 215(a)(3) are very similar to the remedies available under

Title VII ("employment, reinstatement, promotion and the payment of wages lost and an additional equal amount as liquidated"). The Third Circuit Court of Appeals held that an action for damages under section 216(b):

> is a claim asserting the violation of personal injury tort or tort-type right, rather than for an economic right arising out of contract. We reach this conclusion because a suit alleges the violation of a duty owed the plaintiff by the defendant employer which arises by operation of the Act. This duty is independent of any duty an employer might owe his employee pursuant to an express or implied employment contract; it arises by operation of law. Thus, the statutory claim seeks to remedy a statutory violation that the law has defined as wrongful. See Black's Law Dictionary 1660 (rev. 4th ed. 1968) ("Tort" defined as a "wrong independent of contract" and "a violation of some duty owing to plaintiff, and generally such duty must arise by operation of law and not by mere agreement of the

> parties."). It is more tort-like than contract-like, and we therefore hold that the settlement of a claim than an employer has violated section 215(a)(3) of the Fair Labor Standards Act is the settlement of a personal injury claim, as that term is used in section 104(a)(2), and that the proceeds of the settlement are excludable from federal income tax.

Byrne, 883 F.2d at 215

While the holding in Byrne is limited to claims under section 216(b) of the FLSA, the proposition that the injury arises out of a legal duty owed to the employee by the employer which is independent of any contract or agreement between the parties, is equally applicable to claims under the various civil rights acts, including Title VII.

Replete throughout the Congress' consideration of the legislative proposal that culminated in its historic

passage of the Civil Rights Act of 1964 were references to "the injustices and humiliations of racial and other discrimination.[8]

That a Title VII employment discrimination cases involves an affront to human dignity and is thus in the nature of a "dignitary tort"[9] was eloquently stated by Judge Gewin of the Fifth Circuit in one of the first reported Title VII appellate decisions:

> In conclusion, it may be observed that on the surface the present case concerns only the meaning of certain statutory provisions. But

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8 H.R. Report No. 914, Report of House Judiciary Committee accompany H.R. 7152, 88th Cong., 1st Sess. (Nov. 20, 1963) reprinted in Legislative History of Titles VII and XI of Civil Rights Act of 1964 at p. 2018 published by Equal Employment Opportunity Commission.

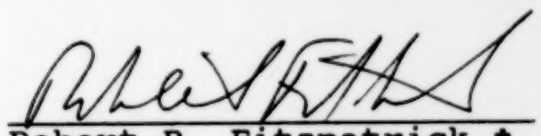
9 Cu is v. Loether, 415 U.S. 18., 195-96 n. 10 (1974).

> beneath the legal facade a faint hope is discernible rising like a distant star over a swamp of uncertainty and perhaps of despair. Those who love their work may sometimes forget that a successful human community requires the performance of may vapid and colorless tasks. Even the most tedious physical labor is endurable and in a sense enjoyable, however, when the laborer knows that his work will be appreciated and his progress rewarded. 'Work without hope,' said Coleridge, 'draws nectar in a sieve, And hope without an object cannot live.' The ethic which permeates the American dream is that a person may advance as far as his talents and his merit will carry him. And it is unthinkable that a citizen of this great country should be relegated to unremitting toil with never a glimmer of light in the midnight of it all."

Miller v. International Paper Co., 408 F.2d 283, 294 (5th Cir. 1968) (footnote omitted).

CONCLUSION

For the foregoing reasons, this Court should affirm the holding below.

By: 

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CERTIFICATE OF SERVICE

I, Robert B. Fitzpatrick, Esq., hereby certify that on this 26th day of December, 1991, caused to be mailed first class, postage prepaid, two copies of the Amicus Curiae Brief of National Employment Lawyers Association in Support of Respondents and on December 31, 1991 two copies of the corrected Amicus Curiae Brief to the following:

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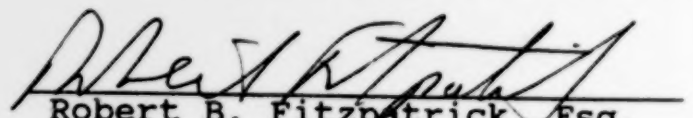

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